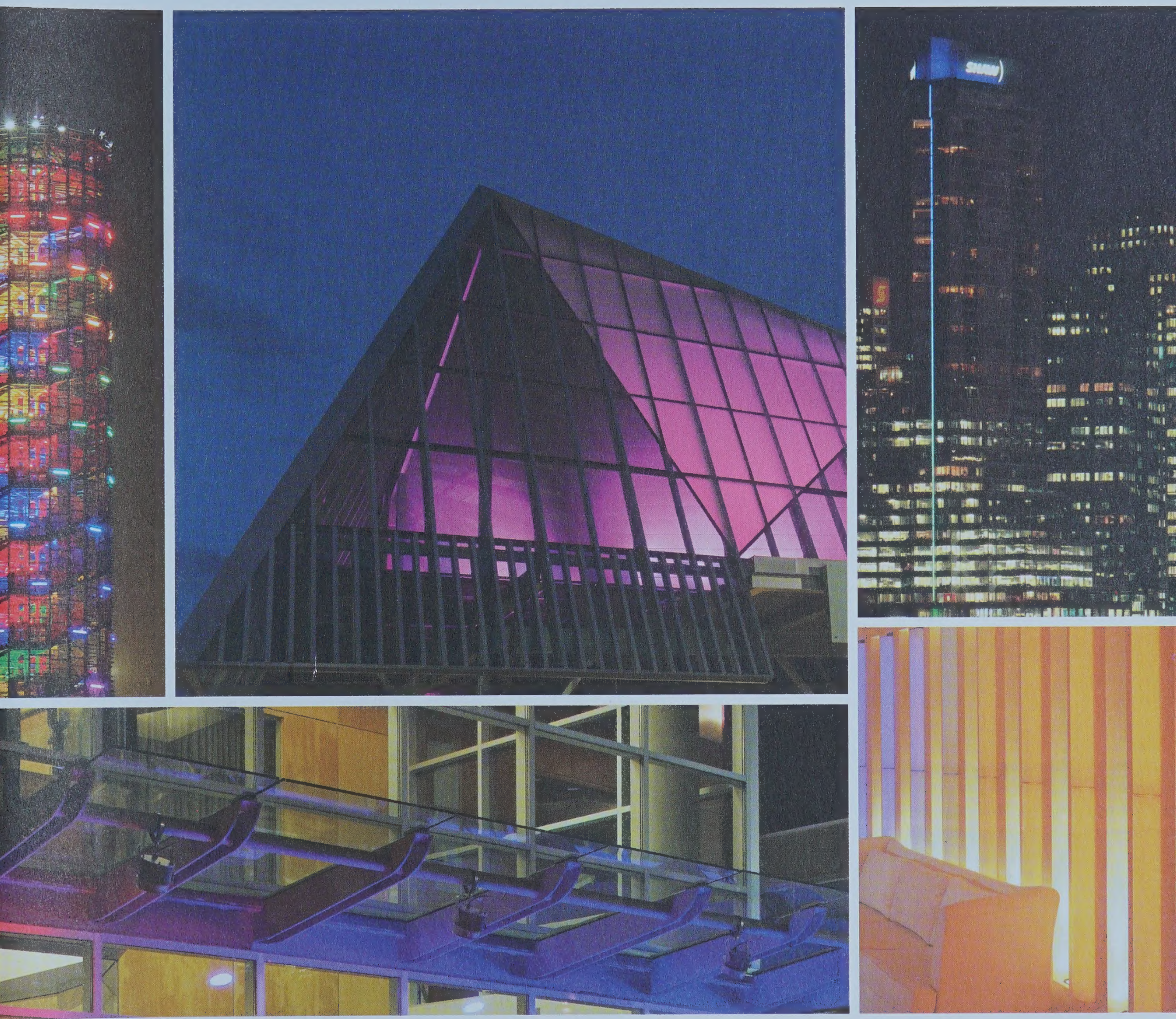


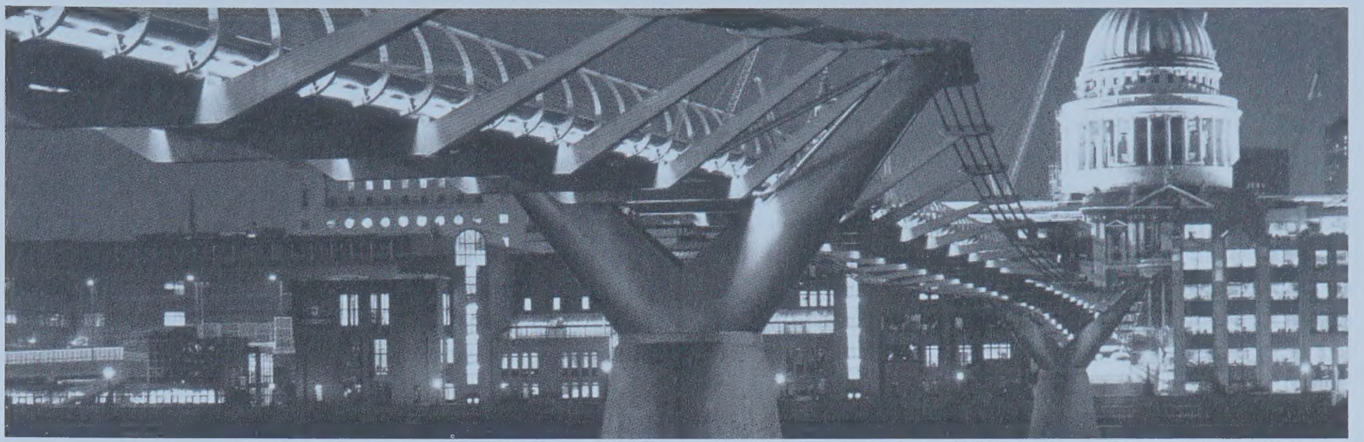
2005 Annual Report

TIR® Building the Foundations of Tomorrow's Lighting

TIR Systems Ltd., a world leader in delivering specialty lighting systems, is building the foundations for tomorrow's lighting. Through sound innovation and proven technical capability, TIR is developing, designing and marketing the core technologies that will allow Solid State Lighting (SSL) to move to the forefront of mainstream lighting.

contents

TIR's LEXEL™ Technology, as showcased at Lightfair, April 2005.



to our shareholders

Last year I reported to you that the Company was entering a transitional year in 2005: one that would be difficult but pivotal to the Company's long-term success. 2005 proved to be just that!

I would like to open by reporting that with the introduction of the LEXEL™, we have made significant strides in achieving our overall goal: to transition from being a specialty lighting manufacturer to creating and delivering an exciting new white light source to global lighting manufacturers, for integration into their product lines.

This powerful new technology is expected to become a standard for mainstream, white light illumination, displacing much of the US$91 billion conventional lighting market in the next two decades. We believe TIR is the only company that has overcome the critical technological hurdles required to enable SSL for general lighting, giving LEXEL™ its leadership position.

The raw Light Emitting Diode (LED) is a component of a lighting system. It runs only as well as the system that operates it. LEXEL™ is such a lighting system, and no other SSL solution delivers the same "mileage" from LEDs as LEXEL™. I quote Dr. Roland Haitz, who once said, *"Edison was the 38th inventor of a filament-based lamp...[but]... the first to deliver the entire lighting system..."*. In the same way, with the introduction of the LEXEL™, TIR has created the first and only fully integrated seamless SSL system. This is an incredible achievement for the Company and one of which we are very proud.

Subsequent to the year-end the Company announced two further significant accomplishments:

- We signed our first two collaborative agreements with some of the world's leading lighting manufacturers to develop LEXEL™-based products:
    - The Genlyte Group (NASDAQ-GLYT) is one of the largest manufacturers of lighting fixtures in the world selling specification grade lighting to the commercial, industrial and residential markets.
    - Lighting Services Incorporated is a leading manufacturer of track, accent, display and fiber optic lighting systems, specifically targeting museum, gallery and high-end retail applications.

  This validates TIR's evolution from being a specialty lighting manufacturer, and establishes the pillars of our OEM strategy to become a truly global supplier of lighting technology.
- TIR strengthened its balance sheet by raising $23.2 million, further confirming the promise of LEXEL™ technology.

Together, these achievements position the Company with the resources and commercial backing to execute its strategy of delivering a new SSL general lighting standard to the world's leading lighting industry manufacturers.

Taking a closer look at 2005, the financial performance of the Company was poor, despite some very positive, emerging trends. While the Company did achieve revenue within the range predicted after a revision midway through the year, profitability was lower than expected.

The weak financial performance is attributable to a number of factors, including new product costs being too high, faster than anticipated price erosion and the challenge of adjusting operating expenses in response to significantly lower revenues, while still maintaining the momentum required to achieve long-term success. During the rapid growth that TIR experienced in 2003 and 2004 and the change in customer and product mix in 2005, our systems, leadership and organizational structure did not keep pace, resulting in the restatement of

our financial results for 2004. Under the leadership of our new CFO, Gary Brown, we have commenced a detailed assessment of resources, processes and policies to enhance our financial reporting. While I do not want to minimize the importance of this improvement, it is important not to lose sight of the significant promise of our new LEXEL™ technology.

Despite the challenging year, Company management and the Board remained steadfast in their commitment to continue investing in long-term initiatives, consistent with realizing its vision of becoming a leader in the provision of technologies that set a new standard for SSL, allowing it to address a broad spectrum of the lighting market. These investments included significant expenditures in the protection of the Company's rapidly developing intellectual property portfolio, which increased by 82% over the course of the year and now stands at five patents and 62 filings. In addition, the Company incurred substantial costs relating to its defense in current legal proceedings. These investments are fundamental to the creation of shareholder value and enabling the Company to not only lead a significant change in the underlying technology for lighting, but to also protect its leadership in SSL as it repositions itself into a strategic light source supplier to global lighting industry manufacturers.

In spite of the weak financial performance, 2005 did prove to be a significant turning point in terms of advancing the Company's vision. Positive trends in TIR's Architectural and Corporate Identity businesses included the following:

- To reduce product costs, the Company successfully transitioned one full product line and several key electronic components to an offshore manufacturing partner by the end of Q4. While the investment associated with this move increased our development expenses in 2005 and thus negatively affected the bottom line, the benefits of reducing product costs are expected to result in improvements in gross margins in 2006. The experience and relationships gained through this process should allow the Company to more easily shift to offshore manufacturing where beneficial and, more importantly, to incorporate this option directly into future product development plans from the start.
- In the Architectural – SSL market, due to the lengthy construction cycle, it generally takes 12 to 24 months for new products to begin to produce a steady flow of orders. Consequently, the Company has just started to experience the benefit from the adoption of its range of Destiny® products, predominantly launched 18 months ago. The result was a 132% increase in revenue over 2004 from its Architectural – SSL business. Noteworthy installations for our Architectural – SSL products included: the spectacular Galaxy Park tower in Tianjin, China; the Louis Vuitton flagship store in Hong Kong; the Experience Music Project in Seattle; Dali's Square in Madrid; as well as the Shaw Tower and Edgewater Casino on our local Vancouver skyline.
- The Company continued to expand its distribution network in Europe for its Corporate Identity products, adding distribution partners in the United Kingdom and the Netherlands. Investments in training our new channel partners and introducing our products to their customers in Europe were completed in the second half of 2005 and we expect to begin realizing the benefits from these investments in 2006, resulting in a significantly more diversified customer base.
- Overall, the percentage of total company revenue derived from non-BP sources increased to 75% this year as compared with 31% in 2004, demonstrating a significant reduction in the reliance on one individual customer, BP. In this regard, it is important to note that non-BP revenue from the Corporate Identity market grew by 197% in 2005, with the number of active Corporate Identity customers increasing from 15 to 67.

The truly compelling turning point, however, came with the introduction of TIR's LEXEL™ technology at Lightfair in New York in April. After investing only two and half years in research, focused on defining and inventing the next generation light source, the Company found itself further along the road of innovation than anticipated and made the momentous decision to introduce this technology to the world.

> ***"The LEXEL™ technology demonstration was truly one of the great highlights of Lightfair 2005. It offers complete flexibility for accent lighting, especially in retail lighting. Icing on the cake is extremely low energy use."*** **– Nancy Clanton, Founder & President of Clanton & Associates**

We are now ready to deliver on the promise of LEXEL™ and our SSL vision, with collaborations that will result in LEXEL™-based products that offer higher quality illumination, potential energy savings of up to 80%, significantly lower maintenance costs and consistent white light maintained over a life measured in decades. LEXEL™, incorporating LEDs, is the basis of our vision and our goal is nothing less than to establish LEXEL™ as a new light source standard that will be embedded into the SSL product lines of the world's top lighting manufacturers.

Looking ahead, the Company has established four initiatives that will create value for our customers and deliver on our vision:

raise additional capital

In the past, the Company has been able to achieve its goals with a minimum level of investment. However, the scope and importance of the investment required over the next two to three years dictate that we be properly capitalized so as to turn our early leadership position in SSL into a dominant role in the lighting industry as a whole as the inevitable switch is made from century-old "analogue" conventional light sources to superior "digital" SSL technology.

Subsequent to the end of fiscal 2005, the Company has successfully raised $23.2 million and has been given the mandate to raise up to $30 million at the extraordinary general meeting held on 25th October 2005. The funds raised are targeted for investment in the commercialization of LEXEL™ technology as well as for general corporate purposes.

commercialize LEXEL™ technology

LEXEL™ technology has been validated with overwhelming early market feedback confirming that the technology exceeds expectations in meeting virtually all of the market needs for SSL illumination.

> ***"...we believe that the LEXEL™ is the first system to offer our clients a quality, usable Solid State Lighting system. Ultimately, the [benefits] will make LEXEL™-based LSI fixtures the light source of choice for museums, galleries and stores"*** **– Daniel Gelman, President of Lighting Services Inc.**

> ***"LEXEL™ technology from TIR [is] very impressive. This will be very useful for our clients, and will change the expectations and specifications for wall and display lighting."***
> **– Joseph Good, Principal of Lighting & Theatre Design, Spectrum Engineers**

We are focused on working with lighting fixture manufacturers to take the technology out of the development lab, implement volume manufacturing processes and deliver products that successfully meet or exceed the requirements of these important OEM customers. The timeline to commercialization is dependent on a variety of commercial and technological factors, is expected to yield nominal revenues in fiscal 2006 and will require several years to achieve wider adoption.

In parallel, the Company will continue to conduct research into advanced lighting technologies for SSL, while at the same time continuing to invest in the protection of its expanding portfolio of intellectual property.

The next few years will be tremendously exciting as we develop SSL-based general lighting products with the worlds leading lighting manufacturers.

establish OEM partners

The Company has set up a Sales & Marketing organization focused on identifying and establishing OEM partners to incorporate TIR's SSL technology into their lighting product lines. Initially, TIR has targeted two types of companies:

- Large lighting manufacturers with a broad range of products operating in a variety of market segments that can influence the market and reach large numbers of end-user customers.
- Lighting manufacturers that are leaders in the high-value market segments that represent key initial markets for SSL illumination.

TIR will work in collaboration with OEM companies to develop both products and marketing plans that draw on their experience and capability in specific market segments, increasing the likelihood of introducing products that have strong market acceptance. This market knowledge and understanding, combined with TIR's expertise in developing leading edge SSL technology and manufacturing highly respected products, creates a powerful momentum in establishing LEXEL™ technology as a new standard for general illumination. These critical relationships also allow TIR to leverage the powerful sales and distribution channels, and strong product brands that these companies have established.

On October 28, 2005, the Company announced OEM agreements with the Genlyte Group, a US$1.2 billion lighting conglomerate delivering products to all market segments in North America, and Lighting Services Inc. (LSI), the leader in the high-value market for museum and gallery lighting and high-end retail segments.

consolidate current business to focus on TIR-branded products

The Architectural – SSL market for colour and colour-changing applications as well the Corporate Identity market are the early adopter markets for SSL and still represent significant growth opportunities for TIR. According to a study of the LED market conducted by Strategies Unlimited and published in July 2005, "the sale of LEDs into the Illumination market is the smallest segment today, but will experience the most rapid growth in the next five years... The rate of adoption is expected to expand significantly, primarily in the coloured lighting segment, although white light will be an increasingly important factor." We believe these observations to be generally accurate and, as a result, expect markets in both coloured and white light to be significant.

To capitalize on this opportunity, we have restructured our Sales, Marketing and Service Delivery organizations. We have also strengthened our core competencies in Engineering and Product Development as well as establishing Manufacturing processes and partnerships that enable products to be manufactured offshore. We are also undertaking a full evaluation of the markets, our product plans and overall competitive position as well as re-evaluating all of our processes, ensuring best business practices are applied throughout the organization with the intention of streamlining operations, driving profitability and ensuring the integrity of our financial reporting.

Since making the strategic commitment to SSL in 2000, the Company has been vigorously pursuing a vision to establish SSL as a viable alternative to conventional light sources and deliver the products that address the global market for general illumination estimated to be US$91 billion. The first part of this vision, building the foundations, has been achieved, and we are now focused on the next steps that will allow the Company to realize its potential and deliver on its inherent value. The TIR team is committed to executing on these four initiatives and delivering results.

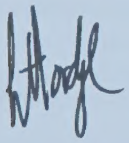
In the wake of the challenging year that we have had, it is easy to lose sight of the significant success the Company has achieved with the development of new technology, establishing a strong foundation from which the goal of becoming a market leader in SSL can be secured. We recognize that we have a great deal of work ahead of us to accomplish this goal, however it is my sincere hope to look back on 2005 as a turning point in creating a company that delivered on its vision and generated value for its stakeholders.

I would like to thank the following groups:

- Our existing shareholders who have supported the Company through what has been a challenging year for all.
- Our new shareholders and partners who share the vision.
- Our Company Directors, including welcoming Craig Enenstein to our Board.
- Employees, past and present, and their families who continue to impress me with their passion for what we are trying to achieve.

It is with the same passion that I look forward to addressing the challenges and opportunities we face in the coming year.

Sincerely,



Leonard Hordyk
PRESIDENT & CEO

TIR was founded in September 1982 to commercialize prism light guide technology invented at the University of British Columbia. Prism light guides operate on the principle of Total Internal Reflection, its acronym forms the basis of the Company's name. The Company has over 20 years of experience in the design and manufacture of indoor and outdoor lighting solutions.

Since fiscal 2000, our focus has been on the development of Solid State Lighting (SSL) solutions, initially for early adopter markets, but more recently for the general lighting markets. These SSL solutions take advantage of the potential energy savings, long life capabilities and electronic attributes inherent in this new technology.

overview of Solid State Lighting

SSL is comprised of a number of components, the key being the light source: Light Emitting Diodes (LEDs) or Organic Light Emitting Diodes (OLEDs). These sources are small semiconductor chips that convert electrical current directly into light without the intermediate step of combustion or excitation of gas that is required in conventional sources. First invented in 1967, LEDs have been used as indicator lights, first in panel displays and eventually in traffic signals and vehicular fleet lighting. In the mid 1990's, a blue colour LED was invented that enabled the possibility of 'white light' for illumination. The light output of LEDs has been doubling approximately every 18 months according to Strategies Unlimited, a Silicon Valley based research firm that covers SSL. This technology is rapidly becoming economically and commercially viable as an alternative to lighting systems that are based on conventional light sources, such as incandescent bulbs or fluorescent tubes.

OLEDs are a less developed technology that makes use of polymers with similar abilities to convert electricity directly into light. The key difference from LEDs is the two-dimensional nature of the light source — for example, a flat sheet of material could emit light from its entire surface. While the light output capability of this technology is not yet on a par with conventional sources, in the long term, five years and beyond, we consider OLEDs to be an important part of SSL.

In order for LEDs (or OLEDs) to be incorporated into a lighting system, several other components are required:

- Efficient power conversion
- Digital control and drive electronics
- Communications capability
- Thermal management
- Efficient optics
- System integration

It is these six components on which TIR's development efforts are focused.

markets for TIR lighting solutions

We regard SSL as a technology that has the potential to revolutionize the lighting industry and capture a large share of the general lighting market in the future for the following reasons:

Energy Savings: Lighting is the largest single consumer of electricity in the world, accounting for 20-25% of the electricity generated, according to the Lawrence Berkeley Livermore Labs. A study commissioned by the U.S. Department of Energy and conducted in 2002 estimates that if SSL follows a reasonable adoption pattern, US$100 billion in cumulative energy savings may be realized by 2020 in the United States.

Long Useful Life: A properly designed, installed and maintained SSL system can provide up to 20 years of useful life, depending upon the application. This attribute can substantially reduce maintenance and re-lamping expenses for end-users.

Small Size: SSL uses light sources that are very small, allowing the use of sophisticated optics that result in more efficient use of the light generated and create the potential for use where conventional vacuum tube technology cannot be used.

Adoption rates for this revolutionary technology are expected to vary, depending on the market. In our view the market can be divided into the following four segments:

1 Architectural

The Architectural market segment is also referred to as "Architainment" meaning the use of architectural lighting for entertainment purposes. We subdivide this market segment into solutions best provided using SSL products and solutions best addressed using Light Pipe products.

Architectural – SSL: In this market segment, coloured light is an important component of the lighting design. Conventional lighting requires the use of filters and mechanical systems to generate coloured light. Filtering white light sources results in very poor energy efficiency, while mechanical systems require considerable maintenance. SSL efficiently generates coloured light and can provide a variety of programmable dynamic effects without any moving parts. Examples of this market segment include: casinos, cinemas, theme parks, landmarks, public art, and signature buildings (e.g. corporate headquarters, skyline dominant buildings, etc.).

Architectural – Light Pipe: TIR has been developing and manufacturing the Light Pipe™ product group for over 20 years. Light Pipe applications range from large scale indoor general illumination and direct lighting in difficult to maintain or high traffic spaces to the creation of lighting effects that transform and highlight structures through delineation, backlighting and direct illumination. The results can be dramatic, creative or highly functional. Examples of this market segment include building highlighting, remote access lighting, swimming pools, and roadway tunnel lighting.

2 Corporate Identity

This market segment involves the use of light primarily as a component of signage, to identify a company brand or identity at a retail location. Customers in this market segment operate multiple locations and use standardized images and lighting to identify their affiliation. Conventional light sources are neon for contour lighting and channel letter illumination, and fluorescent for larger area sign backlighting. We believe that customers in this market segment will value SSL as a replacement for neon because it can reduce electricity consumption by up to 90%, as evidenced by data from our current installations and, if properly designed, can provide over 10 years of useful life. In addition, customers also benefit from low maintenance costs compared to conventional light sources due primarily to the elimination of lamp changes. We expect these same attributes to be valued by customers when SSL technology can match fluorescent lighting in 'white light' output for cost and energy efficiency. Examples of this market segment include: petroleum outlets, convenience stores, fast food chains, big box retail, automotive dealerships, financial institutions, other retail chains.

3 Specialty Illumination

This market segment requires 'white light' products for illumination and represents an early adopter market for SSL solutions due to the significant associated benefits. In general, the advantages of SSL solutions for this market segment will be derived from increased functionality, lower maintenance, increased productivity and environmental benefits. These benefits should result in a compelling case that overcomes the higher initial costs associated with adopting such technology. Examples of applications within this market segment include: machine vision, cold storage and display, cleanroom manufacturing facilities, transportation (i.e. roadway lighting), hazardous area industrial facilities and theatrical lighting.

4 General Lighting

This market segment involves the everyday fixtures that provide the majority of task illumination for commercial buildings, retail establishments and homes. As SSL 'white light' or illumination applications become more economically viable, we believe the overall general lighting market will adopt it for use. We believe that the value proposition associated with the adoption of SSL-based lighting for this market is based on improved functionality, lower maintenance, improved productivity, environmental benefits and lower energy consumption costs that will be compelling enough to overcome higher initial costs. The Company's early focus will be on the high value applications in general lighting including museums and galleries, retail and merchandising, and high-end residential products.

TIR's current business is to provide lighting solutions to the Architectural and Corporate Identity market segments. Once commercially available, LEXEL™-based lighting solutions will allow TIR to pursue the Specialty Illumination and General Lighting markets. The Company routinely and regularly assesses the alignment of its products with long term strategic objectives.

sales channels

For the Architectural markets, we have built a distribution network of lighting manufacturer representatives and distributors throughout North America, Europe and Asia. These representatives and distributors sell to architects and lighting designers who specify the lighting products used by our target markets. This distribution network tends to offer a complete range of products that serve the entire commercial and industrial lighting market, of which the Architectural market segment is the largest.

For the Corporate Identity markets, we currently sell direct, as products need to be delivered to the end user or customer through the customer's existing supply chain. In addition, we are developing relationships with large sign companies to distribute our products into the Corporate Identity market and, to this end, are building distribution networks in North America, Europe and Asia.

The Company has added a dedicated team to develop a global OEM supply business by targeting and engaging light fixture manufacturers in the direct purchase of SSL solutions from TIR, focused primarily on LEXEL™. These manufacturers have established sales channels, brands, and customer relationships that encompass many segments of the lighting industry. By partnering with them to develop products based on TIR's SSL technology, the Company will be able to leverage this existing base to rapidly increase market penetration for its OEM products.

products

Note that in prior periods we referred to TIR's products serving two market segments: (1) Commercial and Industrial and (2) Corporate Identity. In order to avoid confusion, we no longer refer to a Commercial and Industrial market segment as this is synonymous with the Architectural market. For comparative purposes, where in prior periods we referenced the Commercial and Industrial market segment, the reader should replace such reference with the Architectural market. In addition, references to Traditional – Commercial and Industrial have been changed to Architectural – Light Pipe.

Architectural – SSL

SSL products within the Architectural market target a range of architectural applications, including façade, structure, building highlighting and delineation applications. To serve this market, we have introduced our Destiny® Series of advanced SSL products as well as our ColorTrace™ products.

The Destiny® Series currently consists of seven products:

Destiny® CW – provides a surface wash function, offering a highly effective and uniform rectangular distribution of light.

Destiny® CG – provides an asymmetric surface graze function, offering a smooth gradient of coloured light to accentuate both the architectural element and the surface texture.

Destiny® CV – provides an even surface glow and paint-with-colour function, offering a far throw from a concealed linear source, correctly controlling over-brightness at the mounting point.

Destiny® DL – provides a direct view function, offering an unmatched level of brightness and resolution while maintaining the uniformity of a continuous linear element of colour.

Destiny® SL – provides highlighting and facilitates the silhouetting of a surface or a structure, offering an intense rectangular punch of coloured light.

Destiny® LP – provides a direct view function, offering a decorative Light Pipe colour-changing element up to 30' (9.1m) in length that enables installation-challenged applications with ease-of-access to the source.

Destiny® SP – provides a variety of lighting effects from surface grazing to direct illumination of target spaces or objects.

Establishing the Destiny® product line involved the development of advanced optics, power supplies, drivers and control software, and hardware to manage the red, green and blue LEDs to produce any colour of light. These building blocks have been leveraged in developing LEXEL™ technology.

ColorTrace™ uses our LightMark™ (see description below) product to address delineation and cove applications in the Architectural market and comes in six solid colours: red, green, blue, amber, white and yellow as well as a clear extrusion option in the same colours.

Architectural – Light Pipe

The Light Pipe™ business is based on two core Light Pipe products:

- Tubular Series - this product line is intended primarily for outdoor applications such as building highlighting, delineation, feature lighting, tunnel lighting, bus service pits and backlighting.
- Ovoid Series - using a 1,000 watt light source, this product is a larger more powerful Light Pipe line used primarily indoors for swimming pools (marketed as IllumiWave), backlit ceilings, transit platforms and large area, general lighting.

Corporate Identity

Our Corporate Identity business is based on two products: LightMark™ (formerly known as ChipStrip) and LightScript™.

LightMark™ is a linear bar of light that is created by using LEDs within a hollow coloured plastic extrusion. This product currently provides solutions for building canopy delineation to a variety of retailers including: petroleum, fast food restaurants and convenience stores. It comes in six standard colours: red, green, blue, amber, white and yellow.

LightScript™ is a channel letter product that is aimed at replacing the light source for illuminated letters commonly used in signage. The typical channel letter currently relies on neon as its light source. LightScript™ comes in six colours: red, orange, yellow, green, blue and white.

Corporate Identity products provide an ideal neon replacement by using solid state technology to offer substantial energy and maintenance savings. Customers for these products are interested in enhancing their corporate image while realizing these operational benefits.

LEXEL™ Technology

LEXEL™ is a new SSL light source we have developed as an alternative to and eventual replacement for conventional light sources such as incandescent, halogen, compact fluorescent and metal halide. LEXEL™ is the first and only fully integrated and seamless SSL solution that provides dramatic improvement in product life and substantial energy savings, using up to 80% less energy to provide the same amount of light as conventional sources. LEXEL™ products will be sold to lighting fixture manufacturers and incorporated into their product lines to provide perfectly controlled, reliable, precise light output and colour temperature for decades. It has been designed to take advantage of rapidly decreasing LED costs and uses established electronic manufacturing processes to achieve cost levels that will allow it to be cost competitive with conventional lighting sources.

non - financial highlights for 2005, and subsequent to the year end:

- Introduced the LEXEL™ platform, the first and only seamless SSL solution that can deliver the benefits of SSL to the general lighting market, estimated to be a global market of US$91 billion annually.
- Subsequent to the end of fiscal 2005, TIR entered into collaborative agreements with Genlyte Thomas Group LLC (GTG) and Lighting Services Incorporated (LSI) to develop products based on LEXEL™ technology.
  - GTG manufactures, sells, markets and distributes commercial, residential and industrial lighting fixtures and controls and is a wholly-owned subsidiary of The Genlyte Group (Genlyte) (NASDAQ:GLYT), one of the largest manufacturers of lighting fixtures in the world.
  - LSI, based in New York State, is a leading manufacturer of track, accent, display, and fiber optic lighting systems. Collaborative efforts with LSI will focus on the development of products for museums, galleries, and the high-end retail markets.
- Expanded distribution network for Corporate Identity products in Europe, establishing distribution arrangements with two subsidiaries of PaperlinX Limited, The Robert Horne Group in the UK and BührmannUbbens Screen and Sign in the Netherlands.
  - PaperlinX is a leading international paper merchant, operating 48 businesses in 30 countries. The company reported revenue of AUD$7.6 billion for the year ending June 30, 2005.
  - The Robert Horne Group is a wholly-owned subsidiary of PaperlinX. With an estimated 30-35% share of the UK market, the company is a leading supplier of plastics and other graphic material to the UK sign and fabrications industry and has established a nationwide network of branches and logistics centers.
  - BührmannUbbens Screen and Sign is a leading Dutch wholesaler of signage, paper, envelopes and packing material, with an estimated 35% market share of the signage market in the Netherlands.
- Increased intellectual property portfolio by 82% with the current portfolio consisting of five patents and 62 filings.

The following discussion summarizes the significant factors affecting the operating results and the financial condition of the Company for the year ended September 30, 2005 compared to the year ended September 30, 2004, as well as for the fourth quarter of fiscal 2005 compared to the fourth quarter of 2004. This discussion should be read in conjunction with our audited financial statements and related notes that are prepared in accordance with generally accepted accounting principles in Canada ("Canadian GAAP"). This management discussion and analysis is dated as of December 15, 2005.

special note regarding forward-looking statements

The following discussion and analysis of the financial conditions and results of operations contains forward-looking statements for us, which involve known and unknown risks, uncertainties and other factors which may cause our actual results to differ materially from any future results, performance or achievements expressed or implied by such statements.

Forward-looking statements include, but are not limited to, those with respect to: anticipated levels of sales, anticipated future operating results, anticipated timing for and receipt of manufacturing release documents from customers for Light Pipe products and release of site specific information to allow shipments of product against blanket purchase orders from our Corporate Identity clients and the anticipated timing and progress of our product development. These statements are predictions only and actual events or results may differ materially. Factors that could cause such actual events or our actual results to differ materially from any future results expressed or implied by such forward-looking statements include, but are not limited to, our ability to maintain and expand our intellectual property position, the successful development or acquisition of complementary or supplementary products for our Light Pipe or Solid State Lighting product lines, our ability to develop our customer base, and our ability to manufacture products at attractive gross margins, our ability to introduce commercially viable LEXEL™-based products in a reasonable time frame, as well as the risk factors described in the Management Discussion and Analysis, the Notes to Financial Statements, our most recent Annual Information Form under the heading Trends and Uncertainties, and other filings with the Canadian Securities regulatory authorities. Forward-looking statements are based on the beliefs, opinions, and expectations of the Company's management at the time they are made, and the Company does not assume any obligation to update its forward-looking statements if those beliefs, opinions, expectations, or other circumstances should change.

restatement relating to the year ended september 30, 2004:

The Company has restated the financial statements as at September 30, 2004 and for the year then ended as the result of certain accounting errors and omission, summarized as follows:

- Sales cut-off errors
- The omission of recording a sales rebate, certain sales and marketing and general and administrative expenses
- The overstatement of foreign exchange gains
- Reclassification of certain expenses

The following table presents the impact of these adjustments on our previously reported statements of operations for the year ended September 30, 2004:

Restatement of Operations Data for the Year Ended September 30, 2004

($000's)	As Previously Reported	Adjustments	As Restated
Revenues	30,338	(216)	30,122
Gross profit	12,215	(136)	12,079
Operating loss	(1,622)	(339)	(1,961)
Net loss	(1,123)	(519)	(1,642)
Loss per share - basic and diluted	(0.06)	(0.02)	(0.08)

disclosure controls and procedures

The Company maintains disclosure controls and procedures designed to ensure that information in our financial reports is recorded, processed, summarized and reported within the time periods specified by applicable provincial and territorial security legislation and that such information is accumulated and communicated to management, including the Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosures. There are inherent limitations as to the effectiveness of any system of disclosure controls and procedures, including the possibility of human error and circumvention or overriding of the controls or procedures. Accordingly, even effective disclosure controls and procedures can only provide reasonable assurance of achieving their control objectives. Consequently, management applies its judgment in evaluating the cost-benefit relationship of possible controls and procedures.

We carried out an evaluation under the supervision and with the participation of management, including the CEO and current CFO, pursuant to Multilateral Instrument 52-109 – Certification of Disclosure in Issuers' Annual and Interim Filings adopted by the Canadian Securities Administrators, of the effectiveness of our disclosure controls and procedures as of September 30, 2005 (the end of the period covered by this report). The current CFO was appointed to such position as at September 20, 2005. Based on that evaluation, and in light of the accounting errors and omissions noted above, the CEO and current CFO concluded that our disclosure controls and procedures as of September 30, 2005 were not effective. As a result, management has applied compensating procedures and processes as necessary to ensure the reliability of our financial reporting. Accordingly, the CEO and current CFO believe that the financial statements, together with the other financial information included in this report, fairly presents, in all material respects, the financial condition, results of operations and cash flows of the Company as of September 30, 2005 and for the periods then ending.

Under the leadership of the Company's new CFO, a detailed assessment of resources, processes and policies has commenced to improve the effectiveness of our disclosure controls.

Selected Annual Financial Information

Except Gross Margin & Per Share Data ($000's)	**2005**	2004 (Restated)	% Inc (Dec)	2003
Revenue	**16,951**	30,122	-44%	22,388
Gross profit	**2,451**	12,079	-80%	8,114
Gross margin	**14%**	40%	-25%	36%
Net income / (loss)	**(13,042)**	(1,642)	n/a	1,142
Net income / (loss) per share - basic	**(0.58)**	(0.08)	n/a	0.07
Net income / (loss) per share - diluted	**(0.58)**	(0.08)	n/a	0.06

Results of Operations – Year Ended September 30, 2005 Compared to Year Ended September 30, 2004

REVENUE

Revenue by Market Segment ($000's)	**2005**	2004 (Restated)	% Inc (Dec)
Architectural – SSL	**5,007**	2,158	132%
Architectural – Light Pipe	**5,311**	6,541	-19%
Total Architectural revenue	**10,318**	8,699	19%
Corporate Identity	**6,633**	21,423	-69%
Total revenue	**16,951**	30,122	-44%

Overall: Fiscal 2005 was a challenging year for the Company as we responded to the significant decrease in revenue from our largest customer, BP due to the substantial completion, in prior years, of their North American re-imaging program. In 2004, BP represented $20.7 million or 69% of total revenue compared to $4.3 million or 25% of revenue in 2005. Although successful in establishing a more diversified customer base, with non-BP revenues growing by 35% to $12.7 million in 2005, we were unable to fully augment the decline in BP revenues.

Corporate Identity: Revenues from our non-BP customer base increased to $2.3 million in 2005 from $774,700 in 2004, an increase of 197%. This increase is the direct result of efforts made to diversify our customer base by (i) establishing a European

distribution network and (ii) using Tier 2 sign companies to enhance distribution in North America. Tier 2 sign companies generally provide regional, rather than national, coverage to smaller corporate accounts.

Architectural – SSL: Revenues from these products increased by $2.8 million or 132% in 2005. The increased revenue in this market segment in 2005 is due to the launch of our Destiny® Series of products during fiscal 2004, as well as the expansion of our sales and distribution channels in Europe.

Architectural – Light Pipe: The 19% decrease in revenues in this market segment is consistent with historical fluctuations due to the lengthy construction schedules associated with large projects. The 2004 revenue reflects the completion of the O'Hare Airport project accounting for over 46% of Architectural – Light Pipe revenue. In addition, the Dulles Airport project, originally expected to be completed in 2005 was delayed and completion is now expected in 2006.

GROSS PROFIT

Gross profit is the difference between revenues and cost of sales. Cost of sales includes labour, materials, commissions, shipping, warranty, TPC royalty payments and other direct costs related specifically to each sales order, as well as general plant overheads and any expenses relating to obsolete inventory.

Gross profit amounted to $2.5 million in 2005 compared to $12.1 million in 2004, with the decrease being primarily driven by the significant reduction in revenue from BP in 2005. As a percentage of revenue, gross margins declined by 26% to 14% due to the effect of a number of items including (i) a shift in product mix towards our Destiny® Series of products, (ii) underutilization of the manufacturing facility and (iii) a significant increase in inventory obsolescence expense.

Gross profit on the Destiny® Series of products increased in 2005 but continues to remain lower than that of our other products.

Underutilization of the manufacturing facility is the direct result of the lower level of revenue in 2005.

Inventory obsolescence expenses increased by $1.3 million in fiscal 2005 due primarily to (i) a change in the way that we estimate inventory obsolescence to better reflect the rapidly changing nature of the SSL industry and (ii) the effect of introducing newer versions of the Destiny® and LightScript™ products during the year. This new methodology is expected to reduce volatility in future inventory obsolescence expenses.

We have implemented initiatives to improve our gross profit including successfully transitioning one full product line and several key electronic components to an offshore manufacturing partner. We are committed to exploring other opportunities for improvement in this regard.

Operating Expenses

Operating Expenses ($000's)	**2005**	2004 (Restated)	% Inc (Dec)
Sales and marketing	**5,241**	5,123	2%
Customer service and support	**1,549**	2,419	-36%
General and administrative	**5,107**	4,659	10%
Research and development	**3,794**	3,770	1%
Less: Government assistance	**(1,373)**	(1,932)	-29%
Total operating expenses	**14,318**	14,039	2%

Sales and Marketing: Sales and Marketing expenses in 2005 were 2% higher than in 2004 due primarily to increased costs associated with expanding the sales team to provide enhanced coverage for Europe, Middle East and Africa, partially offset by reduced expenditures relating to promotional materials.

Customer Service and Support: Customer Service and Support includes all of the personnel that support the pre-sale, order fulfillment and post-sale customer interactions. The decrease in expenditures in 2005 was a direct result of a review of the staff and services required to support our products and customers, particularly given the expected decline in our BP revenue. A number of initiatives were undertaken including a reduction in staff and corresponding overhead costs.

General and Administrative: General and Administrative expenses increased by $447,800 or 10% in 2005 due primarily to increased (i) legal expense, (ii) bad debt expense and (iii) professional fees. The higher legal expenses relate to increased costs associated with the litigation involving Color Kinetics Incorporated (see [Note 16(c)] to the Financial Statements for further details). Bad debts expense increased as a result of the $372,000 provision taken in 2005 to reflect the portion of a receivable balance due from an outside consultant that is likely to be uncollectible (see [Note 4] to the Financial Statements for further details). The increase in professional fees relates to assistance in establishing OEM partnerships.

Research and Development: Our research efforts are focused on the development of key technologies associated with enabling SSL, specifically technologies associated with (i) power conversion, (ii) digital control and drive electronics, (iii) communications, (iv) thermal management, (v) efficient optics and (vi) system integration.

Research and development costs in 2005 were consistent with those incurred in 2004 with the focus in 2005 being on (i) the development of LEXEL™ technology, (ii) the development of new versions of Destiny® and LightScript™ products and (iii) costs associated with outsourcing the production of certain products and components to an offshore manufacturer. Research and development costs in 2004 were primarily related to the introduction of the Destiny® Series of products.

In April 2005, TIR introduced the LEXEL™ to the world at Lightfair in New York. We believe the LEXEL™ will accelerate the adoption of SSL into the general lighting market, estimated to be US$91 billion annually, by enabling lighting solutions that transform the SSL technology promise into reality. Already delivering up to 1,000 lumens of light, reliably and consistently, the LEXEL™ has been designed to meet the needs of over 60% of the lighting market which uses small bulbs such as the 75W incandescent, to achieve the 800 lumens of light or less that is required for everyday tasks.

The LEXEL™ provides significant benefits as compared to conventional lighting sources, including:

- Significant energy savings. With broad adoption, LEXEL™ technology could enable massive energy savings on a global scale, saving up to 80% of electrical costs with no compromise on light output or quality.
- Significant advantages in the quality of light. LEXEL™ enables lighting applications which will have controllable illumination with precise choices of colour temperature and intensity.
- Long life. LEXEL™-based lighting will last for decades.

Government Assistance: Government assistance consists of Technology Partnerships Canada (TPC) recovery and investment tax credits (ITCs) provided by the Government of Canada and its provinces. TPC is a program designed to reimburse 33.33% of eligible research and development expenses. Government assistance decreased by $559,300 in 2005 to $1.4 million, due primarily to the effects of the following factors:

- Government assistance in 2004 reflected an additional TPC recovery of $471,800 relating to expenditures incurred in fiscal 2003 but for which the requirements for reimbursement were not satisfied until fiscal 2004.
- After restating its financial results for Q1 2005, the $1.1 million write-down of the previously recorded tax asset resulted in a $714,000 reduction of government assistance, reflecting the reversal of the benefit previously recognized relating to ITCs.
- The two factors noted above were partially offset through the filing position associated with the Company's 2004 tax return wherein the Company elected not to claim certain discretionary deductions, thereby generating taxable income with the resulting $735,000 tax liability being fully offset through the claiming of ITCs. This was done to reduce the risk of losing the benefit of ITCs due to their limited carryforward period. Of the ITCs claimed, $697,000 was reflected as government assistance with the difference reducing capital assets.

Other Income / Expense

Other income and expense comprises interest and other income, foreign exchange gains and losses, and interest expense. Interest and other income is mainly comprised of interest earned on available cash balances.

Other Income / (Expense) ($000's)	**2005**	2004 (Restated)	% Inc (Dec)
Interest and other income	**123**	45	173%
Interest expense	**(142)**	(62)	129%
Foreign exchange gain / (loss)	**(144)**	119	-221%
Total other income / (expense)	**(163)**	102	-260%

Total other income/(expense) was an expense of $162,700 in 2005 versus income of $102,100 in 2004. This change was due primarily to foreign exchange losses largely attributable to the effect of the appreciation of the Canadian dollar against the US dollar on our net monetary assets denominated in US dollars. The higher interest expense in 2005 is due to the capital lease financing and the leasehold loan having been established part way through 2004 while being outstanding for all of 2005.

Income Tax

Income tax expense was $1.0 million in 2005, compared to an income tax benefit of $217,000 in 2004. The significant change is due primarily to two factors: (i) the write down of the tax asset recognized in previous years and (ii) the filing position associated with our 2004 tax return.

Over the course of the past two fiscal years, we recorded the future tax benefits of certain tax loss carry forwards, totaling $1,050,000 at September 30, 2004. Management's assessment is that these carry forwards are unlikely to be realized in the near term and therefore we removed this asset from our balance sheet as at December 31, 2004, resulting in a future income tax expense of $277,000 while reducing government assistance by $714,000 and increasing capital assets by $59,000. This write-down resulted in an increase to our total tax valuation allowance (see [Note 15] to the Financial Statements for further details). Management's assessment of the realization of future tax benefits depends on a number of factors, a change in which may allow us to recognize this tax asset in the future.

In addition, in completing its 2004 tax return, the Company elected to defer claiming certain discretionary deductions resulting in an income tax expense of $735,000. This expense was fully offset by ITCs claimed, the benefit of which has been reflected as an increase in government assistance of $697,000 and a reduction in capital assets of $38,000. By claiming ITCs rather than discretionary deductions, the Company preserves those deductions for the reduction of future tax liabilities, and reduces the risk of losing the benefit of ITCs that expire if unused after 10 years.

restated selected quarterly financial information (unaudited)

The following table presents the impact of the accounting errors and omissions, referred to earlier, on our previously reported statement of operations data. We have elected not to amend and refile our previously issued quarterly filings to reflect the effect of these changes. We will reflect these adjustments in all future filings, on a prospective basis.

For the Quarter Ending ($000's)	**Sept. 30, 05**	**Jun. 30, 05**	**Mar. 31, 05**	**Dec. 31, 04***
Revenue	**4,518**	**3,381**	**3,449**	**5,603**
Gross profit	**(189)**	**599**	**582**	**1,459**
Operating loss	**(3,646)**	**(3,048)**	**(2,722)**	**(2,451)**
Net loss	**(4,513)**	**(2,947)**	**(2,690)**	**(2,891)**
Net loss per share - basic	**(0.20)**	**(0.13)**	**(0.12)**	**(0.13)**
Net loss per share - diluted	**(0.20)**	**(0.13)**	**(0.12)**	**(0.13)**

For the Quarter Ending ($000's)	Sept. 30, 04	Jun. 30, 04	Mar. 31, 04	Dec. 31, 03
Revenue	5,721	6,328	8,123	9,950
Gross profit	1,515	2,863	3,329	4,371
Operating income (loss)	(2,340)	(1,905)	163	2,121
Net income (loss)	(1,871)	(1,855)	206	1,879
Net income (loss) per share - basic	(0.11)	(0.09)	0.01	0.11
Net income (loss) per share - diluted	(0.11)	(0.09)	0.01	0.10

* In addition to the errors referred to earlier under the section entitled "Restatement Relating to the Year Ended September 30, 2004", the operations data referred to above for the first quarter of 2005 has been restated to reflect the correct accounting for the removal of the $1.1 million tax asset. Previously, the removal was reflected entirely as a future tax provision. The restated figures reflect the $1.1 million write-down in the asset as a future tax provision of $277,000, a reduction in ITCs of $714,000 being reflected as a reduction in government assistance and $59,000 being reflected as an increase in capital assets. The reduction in government assistance and increase in capital assets is due to the previously recorded asset relating partially to ITCs that were reflected as government assistance or a reduction in the purchase price of capital assets when originally recognized.

results from operations for the quarter ended september 30, 2005, compared with the quarter ended september 30, 2004

The net loss for the three months ended September 30, 2005 (Q4 2005) was $4.5 million, compared to a net loss of $1.9 million for the three months ended September 30, 2004 (Q4 2004). The $2.6 million increase in the net loss is attributable to the reduction in gross profit, increases in other expenses and a higher provision for income taxes, partially offset by lower operating expenses.

Revenue for Q4 2005 was $4.5 million representing a decrease of $1.2 million compared to Q4 2004. The decrease was attributable to a reduction in BP and Light Pipe revenues partially offset by an increase in revenues from both Architectural – SSL and non-BP Corporate Identity customers.

The Company reported a negative gross profit for the quarter of $188,600 compared to a gross profit of $1.5 million in Q4 2004, attributable to lower revenues, lower utilization of the production facility and an expense of $837,800 relating to inventory obsolescence. The inventory obsolescence expense is due to (i) a change in the method used to estimate inventory obsolescence to better reflect the rapidly changing nature of the SSL industry and (ii) the effect of the introduction of new versions of TIR's SSL products. This new methodology is expected to reduce volatility in future inventory obsolescence costs.

Operating expenses were $3.5 million for Q4 2005 representing a decrease of $397,200 from Q4 2004. This decrease is due to lower costs relating to customer service and support and research and development expenses, net of government assistance. These decreases in operating expenses were partially offset by increases in sales and marketing and general and administrative expenses.

Sales and marketing costs for Q4 2005 were $1.2 million, an increase of $177,500 compared to the $1.1 million incurred in Q4 2004. The increase is attributable to costs associated with the expanded European sales force established in 2005.

Customer service and support expenses were $370,800 in Q4 2005 compared to $624,500 in Q4 2004. The decrease in expenses was attributable to staff reductions in response to the decline in our BP revenues.

General and administrative costs in Q4 2005 were $1.9 million, an increase of $283,800 from the $1.6 million incurred in Q4 2004. This increase is primarily due to legal costs associated with the ongoing patent infringement lawsuit involving Color Kinetics Incorporated (see [Note 16(c)] to the Financial Statements for additional information relating to this lawsuit), as well as professional fees relating to consulting work that led to the signing of collaborative agreements with three OEM partners, subsequent to year-end.

Research and development expenses amounted to $1.0 million for Q4 2005, compared to $1.4 million for Q4 2004. This $328,000 decrease is due primarily to the heightened level of expenditures in Q4 2004, relating to the development of our Destiny® Series of products.

Government assistance in Q4 2005 was $1.0 million, compared to $766,900 in Q4 2004, representing an increase of $276,800. This increase is due to the utilization of ITCs in completing the Company's 2004 tax return, resulting in an increase of $697,000 in government assistance. This was partially offset by an additional TPC recovery of $419,000 reflected in Q4 2004 relating to expenditures incurred in Q3 2004 but which were not recognized until an extension of the TPC contract was granted on September 30, 2004.

Other expenses amounted to $131,700 in Q4 2005 compared to other income of $133,500 in Q4 2004. This increased expense is primarily due to increased foreign exchange losses incurred in Q4 2005, largely attributable to the effect of the appreciation of the Canadian dollar against the US dollar on our net monetary assets denominated in US dollars.

In Q4 2005, the Company recognized a current tax expense of $735,000 that was offset through the claiming of ITCs relating to qualified research and development expenditures. This tax expense is attributable to the Company's filing position taken in completing its 2004 tax return, wherein we elected to defer claiming certain discretionary deductions, resulting in an income tax expense of $735,000. This expense was fully offset by ITCs claimed, the benefit of which has been reflected as an increase in government assistance and a reduction in capital assets. By claiming ITCs rather than discretionary deductions, the Company preserves those deductions for the reduction of future tax liabilities, and reduces the risk of losing ITCs that expire if unused after 10 years.

Liquidity and Capital Resources

Sources (uses) of Cash ($000's)	2005	2004
Cash (used) by operating activities	**(6,006)**	(4,734)
Cash provided by financing activities	**8,599**	5,063
Cash (used) by investing activities	**(1,171)**	(2,414)
Net increase / (decrease) in cash and cash equivalents	**1,422**	(2,085)
Cash and cash equivalents at beginning of period	**1,228**	3,313
Cash and cash equivalents at end of period	**2,650**	1,228

Cash used in operating activities was $6.0 million for the year ended September 30, 2005 compared to $4.7 million for the prior year. The net use of cash in operating activities in 2005 was due to our net loss adjusted for non-cash items of $9.5 million, offset by a decrease in our working capital of $3.5 million. The change in working capital was primarily due to a decrease in Accounts Receivable, Government Grants Receivable and Inventory, partially offset by decreases in Accounts Payable and Customer Deposits.

Cash generated by financing activities in 2005 was due substantially to the sale of 2,223,500 common shares of the Company at $4.50 per share for net proceeds of $9.0 million, after share issue costs. Cash of $227,600 was used in the repayment of principal relating to the leasehold improvement loan and capital leases. In 2004, cash from financing activities was generated from (i) a private placement of 1,777,143 common shares at a price of $3.50 per share resulting in net proceeds of $5.7 million and (ii) the exercise of stock options for $454,700.

Cash used in investing activities in 2005 amounted to $1.2 million, comprised of $805,900 relating to the purchase of capital assets (net of proceeds from disposal) and $365,500 relating to the acquisition of patents and intellectual property. In 2004, cash of $2.4 million was used in investing activities with $2.1 million relating to the acquisition of capital assets and $287,400 relating to the acquisition of patents and intellectual property.

As at September 30, 2005 the Company had $2.7 million of cash and cash equivalents. In addition, the following credit facilities are available with a Canadian chartered bank: (i) a $3.0 million demand line of credit to assist in financing operating requirements, (ii) a $1.5 million demand facility for qualified fixed asset purchases, (iii) a $500,000 demand facility to assist with the financing of certain inventory, (iv) a $495,000 standby letter of credit facility which supports the Company's building lease commitments, (v) a $300,000 payroll facility and (vi) a $10 million demand facility to support the execution of foreign exchange hedging instruments. All of these credit facilities are secured by a General Security Agreement over all presently owned and after-acquired property of the Company. As at September 30, 2005, none of the credit facilities have been utilized with the exception of the $495,000 standby letter of credit facility supporting the Company's building lease which was fully drawn at that date.

Subsequent to year end, the Company has raised $23.2 million of additional funds through the issue of convertible debentures which are due on January 27, 2011. The debentures are convertible into shares of TIR common stock at a conversion price of $1.30 for the term of the debenture. In addition, for every $1,000 of debentures purchased, investors also received warrants providing the right to purchase 200 common shares of the Company for a period of 3 years at a price of $1.50 per share. The debentures are secured by the assets of the Corporation and bear interest at an initial rate of 7%. The interest rate is subject to reduction, depending on the quarterly trading price of the Company's common shares. The interest rate is reduced to 0% when such quarterly trading price exceeds the conversion price by more than 225%. Interest on the debentures is payable quarterly, commencing on December 31, 2006.

TIR intends to use the proceeds from the issuance of the debentures to invest in research and development activities, including the commercialization of LEXEL™ technology, as well as for general corporate purposes.

We believe that, following the closings of the convertible debenture financing, we have sufficient cash resources to fund the Company's requirements through to at least the end of the next fiscal year.

Contractual Obligations

The following table quantifies the future cashflows associated with our contractual obligations as of September 30, 2005:

Payments Due by Period ($)	Total	< 1 Year	1 – 3 Years	4 – 5 Years	> 5 Years
Leasehold improvement loan	1,191,300	140,200	280,300	280,300	490,500
Capital lease obligations	911,700	211,600	423,200	276,900	-
Operating leases	8,256,700	934,400	1,868,800	1,966,800	3,486,700
Total contractual obligations	10,359,700	1,286,200	2,572,300	2,524,000	3,977,200

financial instruments

From time to time, the Company uses derivative financial instruments to manage foreign currency exposure. As at September 30, 2005 we had no foreign exchange contracts outstanding.

We transact business in a variety of currencies and, consequently, our operating results are subject to fluctuations in foreign currency exchange rates. In particular, a significant portion of our revenue is denominated in US dollars partially offset by expenses relating to material purchases and salaries. The Company is therefore subject to fluctuations in the exchange rate between the US dollar and the Canadian dollar through our operations in Canada. The strengthening Canadian dollar will continue to affect profitability for us in the short term as some of our current order backlog has been accepted at pricing levels based on a higher exchange rate for the US dollar. If the

quoted exchange rate on these backlog items is below actual levels, then this will cause our Canadian dollar revenue on these orders to be less than anticipated resulting in a lower gross margin. We have a limited amount of operating expenses denominated in US dollars and as such do not expect any positive effect on our current expense base.

Several factors could mitigate the impact of future changes in the value of the Canadian dollar on our financial results. First, approximately 50% of our cost of sales is denominated in US dollars. Second, we are reviewing our current quotes and adjusting the exchange rate and pricing to our customers wherever possible. Finally, we expect to decrease the percentage of our sales denominated in US dollars as we increase the international distribution of our products this will diversify our foreign exchange risk exposure.

critical accounting estimates

In preparing our financial statements, management is required to make certain estimates, judgments and assumptions that we believe are reasonable based upon the information available. These estimates and assumptions affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the period presented.

[Note 2] to the Financial Statements includes a summary of the significant accounting policies used in the preparation of those financial statements. While all of the significant account policies are important to our financial statements, some of these policies are viewed as critical. The significant accounting policies which we believe are the most critical to aid in fully understanding and evaluating our reported financial results include those which follow.

Revenue Recognition: Our revenue streams are the result of a range of activities, from custom designed lighting solutions utilizing a distribution network of lighting manufacturer's representatives to direct sales of standard products to the end user or customer. As a result, our revenue recognition policies can vary depending on the level of customization within the solution and the contractual terms with the customer. Generally, revenue from products is recognized upon shipment provided there is persuasive evidence of an arrangement, no significant obligations remain, the fees are fixed and determinable and collectibility is reasonably assured.

Last year, we implemented an insurance program through Export Development Canada (EDC) requiring new and existing customers to qualify for accounts receivable insurance. Overseas customers who do not qualify for EDC insurance are required to provide a Letter of Credit prior to an order being accepted.

Acquired Intellectual Property and Patent Costs: Acquired intellectual property and patent costs are amortized on a straight-line basis over ten years. If management determines that development of products to which intellectual property or patent costs relate is not reasonably certain, or that costs exceed recoverable value, such costs are charged to operations.

Warranty Costs: Our products are generally covered by a time-limited warranty for varying periods of time. A liability for the expected cost of warranty related claims is established when products are sold and the related revenue is recognized. The amount of liability accrued reflects an estimate of the expected future cost of honoring obligations based on historical experience, product failure rates and expectations of future conditions. Should future product failure rates and/or replacement costs differ from estimated levels, revisions to the estimated warranty liability may be required.

Income Taxes: We follow the liability method of accounting for income taxes. The amounts we record for future income tax assets and liabilities are based on various judgments, assumptions and estimates. These include the tax rates and laws that will apply when the temporary differences reverse, and the likelihood that we will generate sufficient taxable income to utilize non-capital loss carry forwards prior to their expiration.

Due to the numerous variables associated with such judgments, assumptions and estimates, and the effects of changes in circumstances on these valuations, the precision and reliability of the resulting estimates are subject to substantial uncertainties and may change significantly as additional information becomes known.

Stock-based Compensation: We use the fair value method of accounting recommended by the CICA in Section 3870, "Stock-based Compensation and Other Stock-Based Payments", for stock-based compensation awards granted to employees on or after October 1, 2003. The impact of the adoption of this policy is to create a non-cash charge against earnings as described in [Note 11(d)] to our Financial Statements.

Other: Additional information about the Company's Annual Information Form is available on SEDAR at www.sedar.com.

As of December 15th, 2005 the Company had 22,792,854 shares issued and outstanding.

risks and uncertainties

The Company is subject to a number of risks and uncertainties that can significantly affect its financial condition and future financial performance. The risks and uncertainties described below are not the only ones the Company faces. Additional risks and uncertainties, including those that we do not know about now, or that we currently believe are immaterial may also adversely affect our ability to generate revenue and profit.

We have incurred, and expect to continue to incur, substantial losses.
Although we have generated earnings from operations in the past, in fiscal 2005 we incurred substantial losses and expect to continue to incur losses as we focus on the commercialization of LEXEL™ technology and developing markets for the application of such technology.

Demand for our current products may decline and we may be unable to successfully launch new products, resulting in lower revenues.
If the markets in which we compete fail to grow, or grow at a slower pace than we currently anticipate, or if we are unable to establish markets for our new products, it would significantly harm our business, results of operations and financial condition. In addition, demand for one or all of our current products could decline as a result of competition, technological change or other factors.

We may be unable to design and develop new products that gain sufficient commercial acceptance and, as a result, we may be unable to recover our research and development expenses or maintain our market share and our revenues could decline.
We depend on designing and developing new products that have not been commercially tested to achieve much of our future growth. Our ability to design and develop new products depends on a number of factors, including, but not limited to the following:

- Our ability to attract and retain skilled technical employees
- The availability of critical components from third parties
- Our ability to successfully complete the development of products in a timely manner
- Our ability to manufacture products at an acceptable price and quality

A failure by us or our suppliers in any of these areas, or a failure of these products to obtain commercial acceptance, could mean we are unable to recover our research and development expenses and could result in a decrease in our market share and our revenues.

Specifically, we cannot guarantee that we will be able to develop commercially viable products based on LEXEL™ technology to the timetable anticipated, or at all. Commercialization of this technology requires, among other things, establishing a product design that can be manufactured in high volumes at a reasonable cost and establishing market acceptance of such products. We cannot guarantee that we will be able to achieve cost targets required to create sufficient market demand for these products or that these products will gain market acceptance. In addition, establishing market acceptance depends partially on lighting fixture companies designing and manufacturing products based on LEXEL™ technology. We cannot guarantee that such will occur.

Our revenues and earnings may fluctuate from quarter to quarter, which could affect the market price of our Common Shares.
Our revenues and earnings may vary from quarter to quarter as a result of a number of factors, including:

- Concentration in our customer base
- The timing of releases of our new products
- The timing of substantial orders
- Possible seasonal fluctuations in demand
- Possible delays in the manufacture or shipment of current or new products
- Possible delays or shortages in component supplies
- Our ability to successfully complete programs to reduce our cost structure, including fixed costs, to streamline our operations and reduce product costs
- Our ability to obtain payment from our customers on a timely basis
- Our ability to manage inventory levels given the volatility in our sales, the length of the sales cycle and the rapidly changing nature of the SSL industry

As a result, quarter-to-quarter comparisons of our revenues and earnings may not be meaningful. In addition, it is possible that these quarterly fluctuations in revenue and earnings could result in our operating results falling below the expectations of investors and securities

analysts in one or more future quarters. As a result, these quarterly fluctuations in our revenues and earnings may affect the market price of our Common Shares.

Our sales cycles are lengthy.

Our lighting solutions are typically specified for large projects, including tunnels, large corporate identity programs and large scale commercial buildings. In deciding to utilize the Company's products for these projects, the purchaser is typically making a significant financial commitment. Consequently, the Company's sales process is often subject to delays associated with the approval processes of the engineers and contractors working on the project as well as the approval process of the owners of the project. In addition, such projects vary considerably in the time between the commencement and completion of the project. Such projects may also experience delays over which the Company has no control. Any significant or ongoing failure by the Company to ultimately achieve such sales could have a materially adverse effect on the Company's business, results of operations and financial condition.

We may not be able to sustain our current gross margins for any given product and, as a result, our profitability may decrease.

We generally price our products based on our estimate of current and future production costs. If actual production costs are higher than we anticipated, our gross margins will decrease. In addition, competitive pressures may force us to lower our product prices, which may further decrease our gross margins if we are unable to offset that effect by cost reduction measures. If our gross margins are reduced with respect to an important product line, or if our sales of lower margin products exceed our sales of higher margin products, our profitability may decrease and our business could suffer.

We depend on third parties to manufacture our products and supply key components. If they do not manufacture our products properly or cannot meet our needs in a timely manner, we may be unable to fulfill our product delivery obligations, our costs may increase, and our revenue and margins could decrease.

We outsource a substantial part of the manufacture of our products to third parties and depend heavily on the ability of these manufacturers to meet our needs in a timely and satisfactory manner. Some components used by us may only be available from a small number of suppliers, in some cases from only one supplier. Any one of our suppliers may terminate the manufacturing contract with us at any time, subject to agreed notice periods and order backlog fulfillment.

Our reliance on third party manufacturers and suppliers subjects us to a number of risks, including the following:

- The absence of guaranteed manufacturing capacity
- Inability to control the amount of time and resources devoted to the manufacture of our products
- Delays in, or cancellations of planned shipments
- Flaws in supplied products

If we are unable to successfully manage any of these risks or to locate alternative or additional manufacturers or suppliers in a timely and cost effective manner, we may not be able to deliver products in a timely manner. In addition, our results of operations could be harmed by increased costs, reduced revenues and reduced margins.

We may have difficulty responding to changing technology, industry standards and customer preferences, which could cause us to be unable to recover our research and development expenses and lose revenues.

Our success will depend in part on our ability to develop products that keep pace with the continuing changes in technology, evolving industry standards and changing customer and end-user preferences and requirements. Our products embody complex technology that may not meet those standards, changes and preferences. We may be unable to successfully address these developments on a timely basis or at all. Our failure to respond quickly and cost effectively to new developments through the development of new products or enhancements to existing products could cause us to be unable to recover significant research and development expenses, reduce our revenues, and render portions of inventory obsolete.

Competition from larger, more established companies with greater resources may prevent us from increasing or maintaining our market share and could result in price reductions and reduced revenues.

The lighting industry in our primary market, North America, is dominated by four large companies that each generate nearly or greater than US$1 billion in annual revenues. Although these companies do not offer competitive SSL products at this time, we expect competition from these companies to commence shortly. These companies are more established with greater financial and marketing resources that they can use to sell products that compete with ours. Existing or future competitors may be able to respond more quickly to technological developments and changes or may independently develop and patent technologies and products that are superior to ours or achieve greater acceptance due to factors such as more favourable pricing or more efficient sales channels. If we are unable to compete effectively with our competitors' pricing strategies, technological advances and other initiatives, our market share and revenues may be reduced.

We will need to recruit, train and retain key management and other qualified personnel to successfully grow our business.
Our future success will largely depend on the continued service of our executive officers and other key management, sales, marketing and technical personnel. The loss of the services of one or more of our executive officers or other key employees could have a material adverse effect on our business, our results of operations and our financial condition. Although our executive officers and key management have executed confidentiality agreements, they are not subject to any non-competition agreements with us. In addition, our future success depends critically on our ability to recruit and retain highly qualified employees including experienced management, sales and marketing, research and development and customer service personnel. If we do not attract and retain such employees, we may not be able to grow our business. Competition for qualified employees is intense. We may not succeed in attracting or retaining sufficient personnel or it may be necessary for us to increase the level of compensation paid to existing and new employees, causing our operating expenses to be materially increased. In addition, new employees generally require substantial training, which requires significant resources and management attention. Even if we invest significant resources to recruit, train and retain qualified personnel, we may not be successful in our efforts.

Others could claim that we infringe on their intellectual property rights, which may result in substantial costs, diversion of resources and management attention, and harm to our reputation.
It is possible that other parties may claim that we have violated their intellectual property rights. Rights to intellectual property can be difficult to verify. Competitors could assert, for example, that former employees of theirs who we have hired have misappropriated their proprietary information for our benefit. A successful infringement claim against us could damage us in the following ways:

- We may be liable for damages and litigation costs, including legal fees
- We may be prohibited from further use of the intellectual property which could result in suspension or discontinuation of affected products
- We may have to license the intellectual property from third parties, incurring licensing fees and we cannot be assured that such licenses could be obtained at a reasonable cost, or at all
- We may have to develop a non-infringing alternative, which could be costly and result in the loss of sales and write-downs of portions of our inventory

Regardless of the outcome, an infringement claim could result in substantial costs, diversion of resources and management attention, and harm to our reputation.

We are a defendant in an intellectual property and patent lawsuit that may require us to pay substantial royalties or damages, may subject us to other equitable relief or may otherwise seriously harm our business.
We are a party to a lawsuit filed against us by Color Kinetics Incorporated ("CK") in the District Court of Massachusetts. Although we believe that the claims of CK in this lawsuit are without merit, the lawsuit may not ultimately be resolved in our favour. If it is not resolved in our favour, we may be obligated to pay damages, may be obligated to pay an additional royalty or damages for access to the inventions covered by claims in issued US patents, may be subject to such equitable relief as a court may determine (which could include an injunction) or may be subject to a remedy combining some or all of the foregoing.

Misappropriation of our intellectual property could place us at a competitive disadvantage.
Our intellectual property is important to our success. We rely on a combination of patent protection, copyrights, trademarks, trade secrets, licenses, non-disclosure agreements and other contractual agreements to protect our intellectual property. Our intellectual property includes patents, patent applications and numerous trade secrets and know-how. Third parties may attempt to copy aspects of our products and technology or obtain information we regard as proprietary without our authorization. In addition, if we are unable to protect our intellectual property against unauthorized use by others it could have an adverse effect on our competitive position.

Our strategies to deter misappropriation could be inadequate due to the following risks:

- Non-recognition of the proprietary nature or inadequate protection of our methodologies in the United States, Canada or foreign countries
- Undetected misappropriation of our intellectual property
- Non-disclosure agreements may be breached and, if they are, we may not have adequate remedies
- Others may develop technologies that are similar or superior to our technology or design around patents owned or licensed by us
- A substantial amount of our intellectual property consists of trade secrets and know-how, the unauthorized misappropriation of which may be difficult to detect or to prove

In addition, we may have to engage in litigation to protect our patents and other intellectual property rights, or to determine the validity or scope of the proprietary rights claimed by others. Litigation of this nature can be time-consuming and expensive, whether we win or lose. Because it is critical to our success that we are able to prevent competitors from copying our innovations, we intend to continue to seek patent and trade secret protection for our technologies. The process of seeking patent protection can be long and expensive and we cannot be certain that any currently pending or future applications will actually result in meaningful protection or commercial advantage.

Our lighting products include electronic components and are designed to withstand a variety of weather conditions, the failure of which could increase warranty costs.

Despite rigorous quality assurance activities, undetected errors or defects in our products or components may cause failures at any time. We may not be able to sell our products if they have reliability or quality problems. Moreover, errors, defects or bugs can result in additional development costs, diversion of technical and other resources from our development efforts, warranty claims by our customers or others against us, or the loss of credibility with our current and prospective customers. If there is a successful product liability claim against us for an amount exceeding our insurance policy limits, we would be forced to use our own resources to pay the claim, which could materially and adversely affect our business and financial condition.

Potential acquisitions may result in increased expenses and divert management's attention.

In the future, our strategy may rely on expanding our operations and business through strategic acquisitions of businesses and products. Acquisitions involve a number of risks, including:

- Diversion of management's attention during the acquisition process
- Impact on our financial condition due to the timing of the acquisition
- The failure of the acquired business to achieve anticipated revenue levels, cost savings or other synergies

If realized, these risks could result in substantial costs and disrupt our operations. In addition, acquisitions could result in issuances of securities that may dilute the value of our Common Shares.

Fluctuations in exchange rates between the United States dollar and the Canadian dollar may affect our operating results.

The Company's results are reported in Canadian dollars. A substantial portion of our sales and expenses are denominated in US dollars. In addition, we generate revenues and incur expenses in a number of other currencies. Fluctuations in the exchange rate between the Canadian dollar and these other currencies may result in variations in the revenues and earnings of the Company expressed in Canadian dollars and may have an effect on the Company's business and financial condition.

As our business expands internationally, we will be exposed to additional risks relating to international operations.

Our expansion into international operations exposes us to additional risks unique to such international markets, including the following:

- Increased credit management risks and greater difficulties in collecting accounts receivable
- Unexpected changes in economic, environmental, political, and military conditions in those regions
- Unexpected changes in regulatory requirements, exchange rates, trading policies, tariffs and other barriers
- Uncertainties of laws and enforcement relating to the protection of intellectual property
- Language barriers
- Potential adverse tax consequences

Furthermore, if we are unable to develop distribution channels in Europe and the Asia-Pacific region, we may not be able to grow our international operations and our ability to increase our revenue will be negatively impacted.

We have the ability to issue Preferred Shares with preferences over the Common Shares.

Our articles authorize our board to issue, at its discretion, unlimited Preferred Shares. Without shareholder approval, our board has the authority to attach special rights, including voting or dividend rights, to these Preferred Shares. These rights and preferences may be superior to those of the holders of Common Shares and, accordingly, may adversely affect the rights of holders of Common Shares. Preferred shareholders who possess these rights could make it more difficult for a third party to acquire our Company.

We may be required to raise additional capital.

We expect that cash on hand and the additional funds raised subsequent to the 2005 year end will be sufficient to meet our working capital and capital expenditure needs for at least the next 12 months. We may need to raise further funds. Additional financing may not be available on acceptable terms, if at all. We may also require additional capital to acquire or invest. If we issue additional equity securities to raise funds, owners of Common Shares may suffer dilution.

management's responsibility for financial statements

Management is responsible for the preparation of the financial statements and for the consistency therewith of all other financial and operating data presented in this Annual Report.

In preparation of these financial statements, Management selects appropriate accounting policies and uses its judgment and best estimates to report events and transactions as they occur. Management has determined such amounts on a reasonable basis in order to ensure that the financial statements are presented fairly, in all material respects. Management maintains a system of internal controls to ensure, on a reasonable and cost effective basis, that the Company's assets are safeguarded and to facilitate the preparation of relevant, reliable and timely financial information.

External auditors appointed by the shareholders have examined the financial statements. The Audit Committee, consisting entirely of non-management directors, has reviewed these statements with Management and the auditors and has reported to the Board of Directors. The Board has approved the financial statements.

Leonard Hordyk
PRESIDENT & CEO

Gary Brown
CHIEF FINANCIAL OFFICER

to the shareholders of TIR Systems Ltd.

We have audited the balance sheets of **TIR Systems Ltd.** as at September 30, 2005 and 2004 and the statements of loss and deficit and cash flows for the years then ended. These financial statements are the responsibility of the company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these financial statements present fairly, in all material respects, the financial position of the company as at September 30, 2005 and 2004 and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

Ernst & Young LLP

CHARTERED ACCOUNTANTS
Vancouver, British Columbia
December 9, 2005

TIR SYSTEMS LTD.

Incorporated under the laws of British Columbia

balance sheets

As at September 30 ($)	2005	2004 Restated [Note 3]
ASSETS [Notes 9 & 18]		
CURRENT		
Cash and cash equivalents	$ 2,650,300	$ 1,227,900
Accounts receivable	3,054,900	4,674,100
Government grants receivable [Note 14]	883,000	1,517,500
Other receivable [Note 4]	216,600	588,600
Inventory [Note 5]	2,984,600	5,083,200
Prepaid expenses	363,700	358,800
Future tax asset [Note 15]	-	1,050,000
TOTAL CURRENT ASSETS	10,153,100	14,500,100
Capital assets [Note 6]	4,454,600	4,919,400
Patents and acquired intellectual property [Note 7]	794,600	500,800
Deferred charges [Note 8]	180,300	447,800
Deferred financing charges [Note 18]	240,000	-
TOTAL ASSETS	15,822,600	20,368,100
LIABILITIES AND SHAREHOLDERS' EQUITY		
CURRENT		
Accounts payable	1,974,900	3,271,200
Accrued liabilities	3,843,000	3,579,600
Customer deposits	723,300	985,200
Current portion of long term debt [Note 10]	241,500	224,300
TOTAL CURRENT LIABILITIES	6,782,700	8,060,300
Long term debt [Note 10]	1,400,200	1,645,000
TOTAL LIABILITIES	8,182,900	9,705,300
Commitments and contingencies [Note 16]		
SHAREHOLDERS' EQUITY		
Share capital [Note 11]	22,454,000	13,386,500
Contributed surplus [Note 11(d)]	1,774,400	823,200
Deficit	(16,588,700)	(3,546,900)
TOTAL SHAREHOLDERS' EQUITY	7,639,700	10,662,800
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY	15,822,600	20,368,100

See accompanying notes

Stephen Rooney
DIRECTOR

Morgan Sturdy
CHAIRMAN

statements of loss and deficit

For the Year Ended September 30 ($)	2005	2004 Restated [Note 3]
REVENUE [Note 13]	$ 16,951,100	$ 30,121,500
Cost of sales	14,499,800	18,042,900
Gross profit	2,451,300	12,078,600
EXPENSES		
Sales and marketing	5,241,500	5,123,600
Customer service and support	1,549,500	2,419,400
General and administrative	5,106,800	4,659,000
Research and development	3,793,600	3,769,600
Less: government assistance [Note 14]	(1,373,000)	(1,932,300)
	14,318,400	14,039,300
LOSS FROM OPERATIONS	(11,867,100)	(1,960,700)
Interest and other income	122,600	45,100
Interest expense	(141,600)	(62,200)
Foreign exchange gain (loss)	(143,700)	119,200
LOSS BEFORE INCOME TAXES	(12,029,800)	(1,858,600)
PROVISION FOR (RECOVERY OF) INCOME TAXES [Note 15]		
Current	735,000	-
Future	277,000	(217,000)
	1,012,000	(217,000)
NET LOSS	(13,041,800)	(1,641,600)
DEFICIT, BEGINNING OF PERIOD	(3,546,900)	(1,905,300)
DEFICIT, END OF PERIOD	(16,588,700)	(3,546,900)
LOSS PER SHARE - BASIC AND DILUTED [Note 12]	(0.58)	(0.08)

See accompanying notes

statement of cash flows

For the Year Ended September 30 ($)	2005	2004 Restated [Note 3]
OPERATING ACTIVITIES		
Net loss	$ (13,041,800)	$ (1,641,600)
Adjustments for non-cash items:		
Future income tax expense (recovery)	277,000	(258,000)
Reduction in investment tax credits	752,000	-
Depreciation and amortization	1,310,100	924,000
Amortization of deferred charges	267,500	369,600
Stock-based compensation	951,200	821,200
Gain on disposal of capital assets	(12,400)	-
Changes in non-cash working capital balances:		
Accounts receivable	1,619,200	(772,600)
Government grants receivable	634,500	(1,505,100)
Other receivable	372,000	(588,600)
Inventory	2,098,600	(2,193,200)
Prepaid expenses	(4,900)	(89,400)
Accounts payable	(1,230,600)	607,100
Accrued liabilities	263,400	2,353,500
Customer deposits	(261,900)	(2,761,200)
CASH (USED IN) OPERATING ACTIVITIES	(6,006,100)	(4,734,300)
FINANCING ACTIVITIES		
Issue of common shares, net of share issue costs	9,067,500	6,154,200
Deferred charges	-	(995,400)
Deferred financing charges	(240,000)	-
(Repayment) of leasehold improvement loan	(60,600)	(28,200)
(Repayment) of capital lease obligations	(167,000)	(67,200)
CASH PROVIDED BY FINANCING ACTIVITIES	8,599,900	5,063,400
INVESTING ACTIVITIES		
Acquisition of capital assets, net	(829,100)	(2,126,500)
Proceeds from disposal of capital assets	23,200	-
Acquisition of patents and intellectual property, net	(365,500)	(287,400)
CASH (USED) IN INVESTING ACTIVITIES	(1,171,400)	(2,413,900)
INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	1,422,400	(2,084,800)
Cash and cash equivalents, beginning of year	1,227,900	3,312,700
CASH AND CASH EQUIVALENTS, END OF YEAR	2,650,300	1,227,900

SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION		
Cash paid for interest	141,600	62,200
Capital assets financed by capital leases	-	1,055,000
Capital assets financed by leasehold improvement loan	-	909,600
Intellectual property acquired with common stock	-	147,500

See accompanying notes

1 nature of business and basis of presentation

TIR Systems Ltd. (the Company) develops, manufactures and markets the Light Pipe™ and Solid State Lighting products. The Company distributes its products into the architectural and corporate identity markets worldwide through an established network of representatives, distributors and direct sales.

2 summary of significant accounting policies

These financial statements have been prepared in accordance with Canadian generally accepted accounting principles and reflect the following significant accounting policies.

Use of Estimates: The preparation of financial statements in conformity with Canadian generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the period. Actual results could differ from those estimates.

Revenue Recognition: Revenues are derived from the sale of Light Pipe and Solid State Lighting products and are recognized upon shipment provided there is persuasive evidence of an arrangement, no significant obligations remain, the fees are fixed and determinable and collectibility is reasonably assured. The Company does not provide any rights of return or refund provisions in regards to product sales. A provision for potential warranty claims is provided for at the time of sale, based on warranty terms and prior claims experience.

Stock-based Compensation: The Company uses the fair-value method of accounting for stock options granted to employees and directors after October 1, 2003. Compensation costs are recognized on a straight line basis over the vesting period. Fair values are determined using the Black-Scholes option-pricing model.

Cash and Cash Equivalents

The Company considers all highly liquid investments with an original maturity of 90 days or less to be cash equivalents. Cash equivalents are carried at cost, plus accrued interest, which approximates market value.

Inventory

Inventory is valued at the lower of cost, determined on a first-in, first-out basis, and market. Market is considered to be replacement cost for raw materials and net realizable value for work in progress and finished goods.

Capital Assets

Capital assets are depreciated over their estimated useful lives on a declining balance basis, unless otherwise noted, at the following annual rates:

Plant equipment	20%
Computer software	30%
Research and development equipment	30%
Furniture and fixtures	20 to 30%
Office and computer equipment	20 to 30%
Leasehold improvements	Straight-line over lease term
Sales demonstration assets	Straight-line over 2 years

Leases

Leases have been classified as either capital or operating leases. Leases which transfer substantially all of the benefits and risks incidental to the ownership of assets are accounted for as if there was an acquisition of an asset and incurrence of an obligation at the inception of the lease. All other leases are accounted for as operating leases wherein rental payments are expensed as incurred.

Research and Development Costs

The Company expenses all research and development expenditures, except development costs relating to specific products that have a clearly defined future market, which are deferred and amortized over the period in which the benefits are expected to accrue. Research and development expenditures are reduced by government assistance.

Patents and Acquired Intellectual Property

Patents and acquired intellectual property costs are amortized on a straight-line basis over ten years. If management determines that development of products to which intellectual property or patent costs relate is not reasonably certain, or that costs exceed recoverable value, such costs are charged to operations.

Deferred Charges

Deferred charges relating to the Technology Partnerships Canada (TPC) agreement are being amortized at the rate of 15% of the TPC funding earned over the life of the agreement.

Income Taxes

The Company follows the liability method of accounting for income taxes. Under this method, future tax assets and liabilities are determined based on the difference between the accounting and tax bases of assets and liabilities using substantively enacted tax rates that will be in effect for the year in which the differences are expected to reverse.

Government Assistance

During the course of certain research and development programs, financial assistance is received from the government. The Company accounts for such assistance as either a recovery of costs incurred or a reduction of the cost of the related asset acquired.

Fair Value of Financial Instruments

The fair values of financial instruments approximate their carrying values, unless otherwise noted.

Derivative Financial Instruments

The Company uses financial instruments for non-trading purposes to manage fluctuations in foreign currency exchange rates. The Company is exposed to fluctuations in the exchange rates between the Canadian dollar, and other currencies with respect to sales and purchases and the related receivables and payables. The Company monitors fluctuations and takes action, if deemed necessary to mitigate its risks. The Company does not designate any of its foreign exchange contracts as accounting hedges and accounts for all derivative financial instruments using the mark-to-market accounting method.

Foreign Currency

Monetary assets and liabilities denominated in foreign currencies are translated into Canadian dollars at rates of exchange prevailing at the balance sheet date. Revenues and expenses are translated into Canadian dollars at rates of exchange in effect at the related transaction dates. Exchange gains and losses arising from the translation of foreign currency items are included in the determination of net income.

Earnings per Share

Basic earnings per share is computed by dividing net income (loss) available to common stockholders by the weighted average number of common shares outstanding for the period. Diluted earnings per share reflects the dilutive potential of outstanding securities using the treasury stock method.

3 restatement of previous years financial statements

The financial statements as of September 30, 2004 and for the year then ended have been restated to correct for:

- Sales cut-off errors
- The omission of recording a sales rebate, certain sales and marketing expenses and other general and administrative expenses
- The overstatement of foreign exchange gains
- Reclassification of certain expenses

The following is a summary of the effect on the financial statements of the restatement referred to above:

For the Year Ended September 30, 2004 ($)	As Previously Reported	Adjustments	As Restated
REVENUE	30,337,500	(216,000)	30,121,500
Cost of sales	18,122,900	(80,000)	18,042,900
Gross profit	12,214,600	(136,000)	12,078,600
EXPENSES			
Sales and marketing	5,018,600	105,000	5,123,600
Customer service and support	2,362,600	56,800	2,419,400
General and administrative	4,618,100	40,900	4,659,000
Foreign exchange gain (loss)	298,900	(179,700)	119,200
Net loss	(1,123,200)	(518,400)	(1,641,600)
Deficit, beginning of period	(1,905,300)	-	(1,905,300)
Deficit, end of period	(3,028,500)	(518,400)	(3,546,900)
Loss per share - basic and diluted	(0.06)	(0.02)	(0.08)
CURRENT ASSETS			
Accounts receivable	4,773,100	(99,000)	4,674,100
CURRENT LIABILITIES			
Accounts payable	2,851,800	419,400	3,271,200

4 other receivable

On August 12, 2004, the Company signed a Settlement, Release, Guarantee and Pledge Agreement (the "Agreement") with an outside consultant who was hired to assist in the preparation of the Technology Partnerships Canada ("TPC") application. The Agreement required the consultant to return to the Company by December 31, 2004 the $995,400 paid for his services. The amount owing was collateralized by a pledge of 300,000 common shares of the Company that were beneficially owned by the consultant. In September, 2004, the consultant sold 100,000 common shares for proceeds of $406,800 which were paid to the Company leaving an outstanding balance of $588,600 at September 30, 2004. The Agreement provided that if the amount owing was not repaid in full on or before December 31, 2004, the Company is entitled to enforce the pledge using various remedies, including selling or canceling the common shares pledged as collateral. The Company has written down the carrying value of the receivable to reflect management's best estimate of the net realizable value.

5 inventory

($)	**2005**	2004
Raw materials	**1,995,000**	3,280,700
Work in progress	**201,000**	354,400
Finished goods	**788,600**	1,448,100
	2,984,600	5,083,200

6 capital assets

2005 ($)	Cost	Accumulated Depreciation and Amortization	Net Book Value
Plant equipment	**2,188,000**	**861,900**	**1,326,100**
Computer software	**1,188,600**	**699,900**	**488,700**
Research and development equipment	**504,300**	**245,900**	**258,400**
Furniture and fixtures	**1,349,600**	**701,700**	**647,900**
Office and computer equipment	**1,235,900**	**731,500**	**504,400**
Leasehold improvements	**1,232,400**	**182,400**	**1,050,000**
Sales demonstration Inventory	**327,100**	**148,000**	**179,100**
	8,025,900	**3,571,300**	**4,454,600**

2004 ($)	Cost	Accumulated Depreciation and Amortization	Net Book Value
Plant equipment	1,958,000	549,300	1,408,700
Computer software	1,133,000	518,600	614,400
Research and development equipment	464,600	128,000	336,600
Furniture and fixtures	1,320,600	524,600	796,000
Office and computer equipment	1,163,500	564,200	599,300
Leasehold improvements	1,225,700	61,300	1,164,400
	7,265,400	2,346,000	4,919,400

Included in plant equipment, computer hardware and office equipment are assets under capital leases with an original cost of $1,055,000 and related accumulated amortization of $298,500 [2004 - $118,100].

During the year, the Company has recognized an increase of $21,000 [2004 - decrease of $52,000] for investment tax credits and $14,200 [2004 - $156,000] of TPC assistance relating to capital assets.

7 patents and acquired intellectual property

2005 ($)	Cost	Accumulated Depreciation and Amortization	Net Book Value
Patents	**479,800**	**70,000**	**409,800**
Acquired intellectual property	**412,200**	**42,400**	**369,800**
Trademarks	**16,100**	**1,100**	**15,000**
	908,100	**113,500**	**794,600**

2004 ($)	Cost	Accumulated Depreciation and Amortization	Net Book Value
Patents	222,100	35,000	187,100
Acquired intellectual property	317,900	6,700	311,200
Trademarks	2,600	100	2,500
	542,600	41,800	500,800

During the year, the Company has recognized $103,700 [2004 - $46,000] of TPC assistance relating to patents and acquired intellectual property.

8 deferred charges

Deferred charges represent the unamortized amount of a $995,400 payment to Industry Canada in connection with the Company's amended TPC funding agreement [Note 14]. This amount is being amortized at the rate of 15% of the TPC funding earned over the life of the agreement. As of September 30, 2005 the accumulated amortization amounted to $815,100 [2004 - $547,600].

9 bank indebtedness

The Company's banking agreement provides a $3.0 million operating line, a $300,000 payroll facility, a $500,000 packing loan to assist in the financing of cost of goods sold, a $550,000 letter of credit facility to provide for a building lease commitment, a $1.5 million capital lease facility to finance existing equipment and a $10.0 million foreign exchange loan to purchase foreign forward exchange contracts.

The loans bear interest at prime plus 5/8% to 2% depending on the facility [prime rate at September 30, 2005 - 4.25%] and are collateralized by a general security agreement covering all assets and an assignment of inventory and insurance proceeds.

As at September 30, 2005, there was no balance outstanding under the operating line. During the year, the letter of credit facility and the capital lease facility were utilized as discussed in [Note 10]. The banking agreement contains restrictive covenants with respect to maintenance of certain financial ratios. As at September 30, 2005, the Company was in compliance with the covenants.

10 long term debt

($)	**2005**	2004
Leasehold improvement loan [a]	**820,800**	881,400
Capital lease [b]	**820,900**	987,900
Total long term debt	**1,641,700**	1,869,300
Less: current portion	**(241,500)**	(224,300)
Long term portion	**1,400,200**	1,645,000

[a] Leasehold Improvement Loan: In conjunction with the facilities lease agreement the Company obtained a leasehold improvement loan from the landlord. The original loan amount was $909,600 with an interest rate of 9.5%. This loan is to be paid off over 10 years based on blended principal and interest payments of $11,700 per month. The loan is collateralized with a $550,000 letter of credit. This letter of credit has been set up on a declining amount basis and was reduced by $55,000 to $495,000 on March 1, 2005 and will be reduced by a further $55,000 annually until February 28, 2009, on which date it will expire. Interest expense relating to the leasehold improvement loan for the year was $79,600 [2004 - $41,800].

Principal repayments on the leasehold improvement loan due over the next five years and thereafter are as follows:

($)	
2006	66,500
2007	72,900
2008	80,000
2009	87,800
2010 and thereafter	513,600
	820,800

[b] Capital Lease Obligations: In the prior year, the Company entered into a capital lease financing agreement with HSBC Bank Canada to finance $1,055,000 of qualified fixed asset purchases at an annualized interest rate of 5.24% with a five year repayment term. The blended principal and interest payments are $17,600 per month. Interest expense relating to the capital leases for the year was $44,600 [2004 - $15,100].

The Company's obligations under capital lease agreements consist of:

($)	
Minimum lease payments payable	911,700
Less: portion representing interest to be recorded over the remaining term of the leases	90,800
	820,900
Less: current portion	(175,000)
Long-term portion	645,900

Future minimum annual lease payments payable under the capital lease are as follows:

($)	
2006	211,600
2007	211,600
2008	211,600
2009	276,900
	911,700

11 share capital

[a] Authorized: At the Company's Annual General Meeting on February 7, 2005, the shareholders approved a change in the share capital of the Company to authorize the issuance of an unlimited number of common and preferred shares. Prior to this change, the Company had been authorized to issue 100,000,000 shares of common stock without par value and 10,000,000 shares of preferred stock without par value. No shares of preferred stock are issued and outstanding in the periods presented.

[b] Issued and Outstanding Common Shares

($)	Number of Shares	Amount
Balance, September 30, 2003	17,659,423	7,084,800
Issued pursuant to exercise of options	1,016,865	454,700
Issued to acquire intellectual property	25,000	147,500
Issued pursuant to private placement	1,777,143	5,699,500
Balance, September 30, 2004	20,478,431	13,386,500
Issued pursuant to public offering	2,223,500	9,006,500
Issued pursuant to exercise of options	90,923	61,000
Balance, September 30, 2005	22,792,854	22,454,000

On December 23, 2003, the Company completed a private placement for the issuance of 1,777,143 common shares at $3.50 per common share for net cash proceeds of $5.7 million (after share issuance costs of $520,500).

On November 3, 2004, the company completed a public offering for the issuance of 2,223,500 common shares at $4.50 per common share for net cash proceeds of $9.0 million (after share issue costs of $999,300).

[c] Stock Option Plan: 1999 and 2001 Incentive Stock Option Plans (collectively the "Plans")

The following table sets out the authorized shares originally approved and amended under each plan:

	Date Amended	Common Shares Authorized
1999 Incentive Stock Option Plan	October 29, 1999	1,709,641
2001 Incentive Stock Option Plan	February 7, 2005	3,500,000
Total authorized		5,209,641

During 2004 and 2005, the shareholders approved separate amendments to the 2001 Incentive Stock Option Plan increasing shares available by 660,000 and 700,000 respectively.

The Plans entitle directors, officers, employees and consultants to purchase common shares of the Company. Options immediately become exercisable once vested. The options generally vest with the recipients over three to four years from the date of grant and have a contractual life of five years. Any options that do not vest as the result of a grantee leaving the Company are forfeited and the common shares underlying them are returned to the reserve.

Activity under the Plans is set forth below:

($)	Share Available for Grant	Options Outstanding Number of Optioned Common Shares	Price Per Share	Weighted Average Exercise Price
Balance, September 30, 2003	749,438	2,098,985	0.15 – 1.50	0.66
Amendment of 2001 Plan	660,000	-	-	-
Options granted	(1,196,866)	1,196,866	2.28 – 6.40	5.36
Options exercised	-	(1,016,865)	0.15 – 2.28	0.45
Options forfeited/expired	35,260	(35,260)	0.51 – 6.40	3.01
Balance, September 30, 2004	247,832	2,243,726	0.45 – 6.40	3.23
Amendment of 2001 Plan	700,000	-	-	-
Options granted	(343,200)	343,200	1.15 – 2.55	1.36
Options exercised	-	(90,923)	0.45 – 2.28	0.67
Options forfeited/expired	144,627	(144,627)	0.51 – 6.40	3.17
Balance, September 30, 2005	749,259	2,351,376	0.45 – 6.40	3.08

At September 30, 2005 the following stock options were outstanding and exercisable:

	Options Outstanding			Options Exercisable	
Exercise Price	Number of Shares Under Option	Weighted Average Exercise Price	Weighted Average Remaining Contractual Life (Years)	Number of Options Currently Exercisable	Weighted Average Exercise Price
0.45 – 0.65	331,884	0.50	0.8	331,884	0.50
0.75 – 0.89	308,996	0.85	1.8	306,744	0.85
1.15 – 1.54	567,446	1.27	3.9	224,395	1.25
2.28 – 3.77	387,084	3.24	3.3	216,242	3.31
6.30 – 6.40	755,966	6.40	3.4	213,391	6.40
	2,351,376	3.08	3.1	1,292,656	2.15

[d] Stock-based Compensation: The Company adopted the fair value method of accounting for stock-based compensation on a prospective basis for options granted on or after October 1, 2003. Compensation expense for the periods presented has been recorded in the statement of loss as follows:

($)	**2005**	2004
Cost of sales	**100,200**	72,200
Sales and marketing	**242,400**	138,100
Customer service and support	**79,400**	63,100
General and administrative	**362,600**	441,500
Research and development	**166,600**	106,300
	951,200	821,200

The total fair value of the options granted is measured on the grant date and expensed in the statement of loss on a straight line basis over the vesting term. The fair value is estimated using the Black-Scholes option pricing model and resulted in the following amounts:

	2005	2004
Total fair value of options granted during the year:	**$205,796**	$3,923,975
Weighted average assumptions:		
Dividend yield	**0.0%**	0.0%
Annualized volatility	**63.0%**	93.4%
Risk-free interest rate	**3.3%**	3.6%
Expected life (years)	**3.0**	3.5
Weighted average fair value	**$0.60**	$3.30

[e] Pro Forma Disclosure of Stock-based Compensation

The following pro forma results reflect the fair value method of accounting for stock-based compensation for options issued to employees and directors from October 1, 2002 to September 30, 2003:

($)	**2005**	2004 (Restated [Note 3])
Net loss as reported	**(13,041,800)**	(1,641,600)
Compensation expense under the fair value method	**(41,700)**	(81,900)
Pro forma net loss	**(13,083,500)**	(1,723,500)
Basic and diluted loss per share:		
As reported	**(0.58)**	(0.08)
Pro forma	**(0.58)**	(0.09)

[f] Warrants: The Company has 103,400 warrants outstanding that were issued in connection with the private placement completed on December 23, 2003 [Note 11(b)]. Each warrant entitles the holder to purchase one common share at an exercise price of $3.50 per share until December 23, 2005.

12 loss per share

The reconciliation of the numerator and denominator for the calculation of basic and diluted loss per share is as follows:

($)	**2005**	2004 (Restated [Note 3])
Basic and diluted loss per share:		
Numerator:		
Net loss as reported	**(13,041,800)**	(1,641,600)
Denominator:		
Weighted average number of common shares outstanding	**22,564,725**	19,701,041
Loss per share – basic and diluted	**(0.58)**	(0.08)

13 segmented information

The Company operates in a single business segment, the development, manufacture and marketing of Light Pipe and Solid State Lighting products. Within the segment, the chief operating decision maker, the Chief Executive Officer, evaluates the performance of the business based upon revenues from products, markets and geographic regions.

Revenue derived from these sources is as follows:

($)	2005	2004 (Restated [Note 3])
Product Revenues		
Light Pipe	**5,311,300**	6,540,800
Solid State	**11,639,800**	23,580,700
	16,951,100	30,121,500
Market Revenues		
Architectural	**10,318,100**	8,698,500
Corporate Identity	**6,633,000**	21,423,000
	16,951,100	30,121,500
Geographic Revenues		
Canada	**2,853,000**	1,158,600
United States	**10,023,500**	25,694,100
Australia	**165,200**	1,181,000
Europe	**1,302,500**	1,018,100
Asia	**2,381,300**	1,022,500
Other	**225,600**	47,200
	16,951,100	30,121,500

One customer, a petroleum retailer, accounted for 25% ($4.3 million) of revenues during 2005 (2004 - 69%, $20.7 million). Accounts receivable owing from this customer accounted for 18% ($554,700) of accounts receivable as at September 30, 2005 (September 30, 2004 - 43%, $2.0 million). One other customer accounted for 16% ($491,400) of accounts receivable as at September 30, 2005 (September 30, 2004 - 10%).

All of the Company's assets are located in Canada.

14 government assistance

($)	2005	2004
Investment tax credits	**(17,000)**	41,000
Technology Partnership Canada	**1,390,000**	1,891,300
	1,373,000	1,932,300

Investment Tax Credits: Investments tax credits are accrued when qualifying expenditures are made and when there is reasonable assurance that the credits will be realized. The amounts recorded reflect the benefit of previously unrecognized investment tax credits for which realization was uncertain.

Technology Partnership Canada (TPC): On November 5, 2001, the Company finalized an agreement with TPC, whereby TPC will provide funding of 33.33% of eligible costs related to the research and development of "High Efficiency Intelligent Opto-electronic Lighting Devices" to a maximum funding of $6,636,271. Under the terms of the agreement, the funding was limited to $1,187,000 until the Company raised additional equity in the amount of $6,000,000 including the completion of $4,000,000 of equity financing. The Company met these requirements during the first quarter of fiscal 2004, based on the private placement described in [Note 11(b)]. The funding of this project will cease in March 2006.

In the third quarter of fiscal 2004, TPC initiated an audit of its contract award process with the Company. As a result of the audit, the Company signed an amendment to its agreement with TPC whereby the Company returned $995,400 of the overall $6,636,271 contribution to Industry Canada. Separately, the Company's outside consultant, who was hired to assist in the preparation of the TPC application, agreed to return to the Company the $995,400 paid for his services. The combination of these two agreements did not affect the Company's operating results in 2004, however, as described in [Note 4] the Company has written down the carrying value of the receivable from the consultant to reflect management's best estimate of the net realizable value.

For the year ended September 30, 2005, the Company has received or accrued $1,775,400 [2004 - $2,462,900]. This has resulted in a credit to the Company's income statement of $1,390,000 [2004 - $1,891,300] of which $999,200 [2004 - $1,364,300] relates to research and development costs and $390,800 [2004 - $527,000] relates to sales and marketing and general and administration expenses. A credit of $117,900 [2004 - $202,000] was recorded against capital asset and patent purchases and deferred charges were amortized by $267,500 [2004 - $369,600].

In return for the funding, the Company is obligated to provide royalty payments on annual gross revenues beginning on October 1, 2001. The royalty rate is as follows:

October 1, 2001 to September 30, 2004	0.3%
October 1, 2004 to September 30, 2011	0.9%

If at September 30, 2011, the total cumulative royalty payments exceed $12,991,670, the payment of royalties will end, otherwise the royalty payments will continue until either this amount has been paid or until September 30, 2016, which ever occurs first.

15 income taxes

The Company is subject to the combined federal and provincial income tax rate of approximately 35.6% [2004 - 36.1%]. The reconciliation of the income tax expense (recovery) at the statutory rate compared to the Company's actual income tax expense (recovery) is as follows:

($)	**2005**	2004 (Restated [Note 3])
Income tax recovery at the combined statutory rate	**(4,285,000)**	(671,000)
Decrease (increase) in recovery resulting from:		
Unrecognized temporary differences	**3,922,000**	187,000
Recognized temporary differences	**735,000**	(71,000)
Stock-based compensation not deductible for tax purposes	**339,000**	297,000
Write off of future tax asset	**277,000**	-
Other expenses not deductible for tax purposes	**24,000**	41,000
Income tax expense (recovery)	**1,012,000**	(217,000)

Significant components of the Company's future tax assets as of September 30 are shown below.

($)	**2005**	2004 (Restated [Note 3])
Future tax assets:		
Research and development deductions and credits	**3,406,000**	2,109,000
Tax loss carry forwards	**2,886,000**	125,000
Expenses not yet recognized for tax purposes	**399,000**	350,000
Excess of tax basis over book value of capital assets	**479,000**	-
Share issue costs	**387,000**	172,000
Total future tax assets	**7,557,000**	2,756,000
Valuation allowance	**(7,491,000)**	(1,236,000)
Total future tax assets	**66,000**	1,520,000
Future tax liabilities:		
Excess of book value of capital assets over tax basis	**-**	(292,000)
Income not yet recognized for tax purposes	**(66,000)**	(178,000)
Total future tax liabilities	(66,000)	(470,000)
Net future tax assets	-	1,050,000

As at September 30, 2005, the Company has approximately $5,966,100 of scientific research and experimental development expenditures, which can be carried forward indefinitely to reduce taxable income of future taxation years. As at September 30, 2005, the Company has

approximately $8,458,000 of non-capital tax losses, which can be carried forward for a period of ten years to 2015 in order to reduce taxable income of future taxation years.

The Company has approximately $1,883,600 of federal and provincial investment tax credits available to reduce taxes payable for future years that expire over various dates to 2015. For financial reporting purposes, the Company has not recognized the potential income tax benefit relating to the total future tax assets as their realization does not meet the requirement of "more likely than not" under the liability method of tax allocation.

16 commitments and contingencies

[a] Operating Leases

At September 30, 2005, the Company is committed to payments under operating leases for premises as follows:

($)	
2006	934,400
2007	934,400
2008	934,400
2009	970,600
2010 and thereafter	4,482,900
	8,256,700

[b] Foreign Exchange Contracts: As at September 30, 2005, The Company has no foreign exchange contracts for the forward sale of any currency for Canadian dollars [2004 - US$1.0 million].

[c] Legal Contingencies: The Company was served with a patent infringement lawsuit on December 12, 2003. The lawsuit is currently in a discovery phase. Management firmly believes that the Company has not infringed the stated patents and that the claim is invalid and based on that assessment the Company has not reserved any amount for a potential settlement or judgment against it. However, this claim is likely to increase legal expenses for defense of the suit. Although it is not possible to predict the outcome of this claim with certainty, management believes that this will not have other material effects on the financial position of the Company.

During 2005, the Company was notified by the receiver of one of its former customers who has filed for US bankruptcy protection, asserting a claim of preferential payments to the Company amounting to US$480,000. Based upon consultation with its legal counsel, the Company believes that this claim is without merit and accordingly no amount in respect of this claim has been provided for.

In the ordinary course of business activities, the Company may be contingently liable for litigation and claims with customers, suppliers and former employees. Management believes that adequate provisions have been recorded in the accounts where required.

17 comparative figures

In addition to the prior period restatements disclosed in [Note 3], the Company has reclassified certain of the comparative figures to conform to the presentation adopted in the current period.

18 subsequent events

Subsequent to the year end the Company successfully raised $23.2 million of additional funds through the private placement of convertible debentures due January 27, 2011. The debentures are convertible into common shares of the Company at any time prior to maturity at the option of the debenture holder at a conversion price of $1.30 per share. The debentures bear interest at an initial rate of 7%. The interest rate is reduced by 1.5% for each 25% increase in the Company's stock price above the $1.30 conversion price, such that the interest rate will be reduced to 0% when such quarterly trading price exceeds $2.925 per share. Interest on the debentures is payable quarterly, commencing December 31, 2006.

The Company has also issued 4,643,000 warrants to the debenture holders. Each warrant entitles the holder to purchase one common share of the Company at an exercise price of $1.50 per share until October 27, 2008.

The financial instruments described above will be classified in the Company's financial statements according to the separate debt and equity component parts using the relative fair value method resulting in (i) $13.6 million being allocated to contributed surplus representing

the relative fair value of the conversion feature and the warrants as determined by the Black-Scholes option pricing model, and (ii) $9.6 million being allocated to the carrying value of the convertible debentures. The $9.6 million carrying value of the convertible debentures will be accreted to the $23.2 million principal amount over the term to maturity using the effective interest method and the corresponding interest expense will be included in the statements of profit and loss.

In connection with the private placement, the Company paid cash of $522,100 and issued an additional 276,692 warrants with an exercise price of $1.30 per share until October 27, 2010 to third parties as compensation for sourcing the investment funds. In addition, the Company also paid other professional fees in the sum of $542,300. The aggregate fair value of the third party compensation and professional fees amounted to $1.3 million and will be accounted for as financing fees and allocated to the underlying debentures and contributed surplus on the same pro-rata basis as the original proceeds were allocated.

The debentures are collaterialized by the assets of the Company pursuant to a general security agreement.

directors

Morgan Sturdy, CHAIRMAN

Leonard Hordyk, PRESIDENT & CEO

Harry Jaako, DIRECTOR

Stephen Rooney, DIRECTOR

Craig Enenstein, DIRECTOR
(Appointed October 27th, 2005)

corporate information

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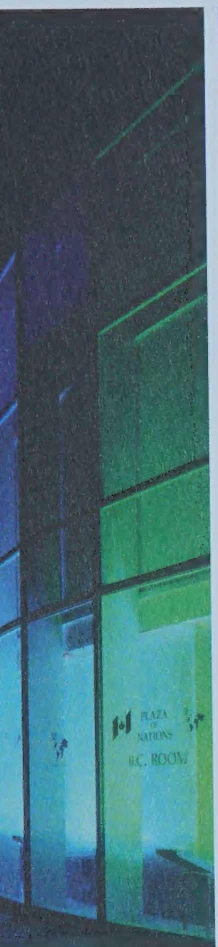
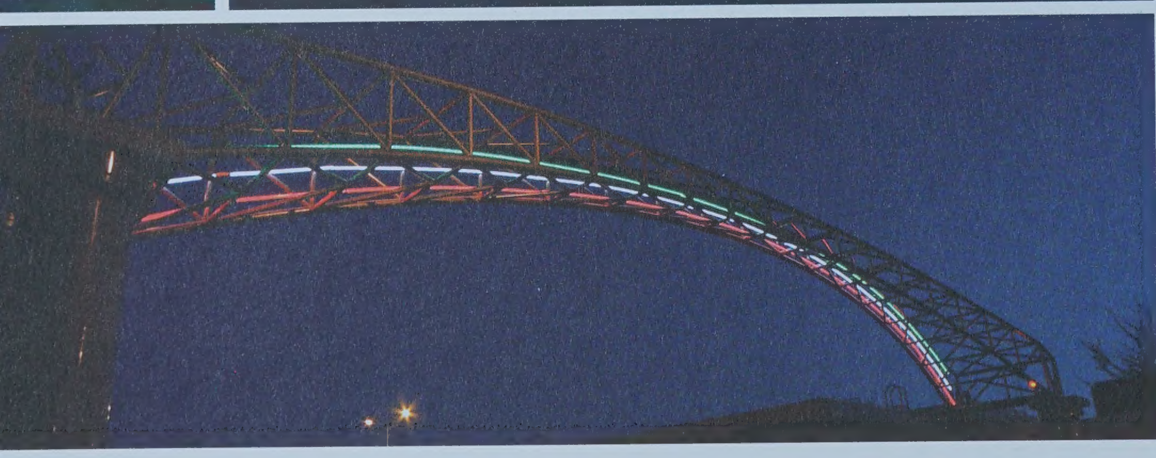
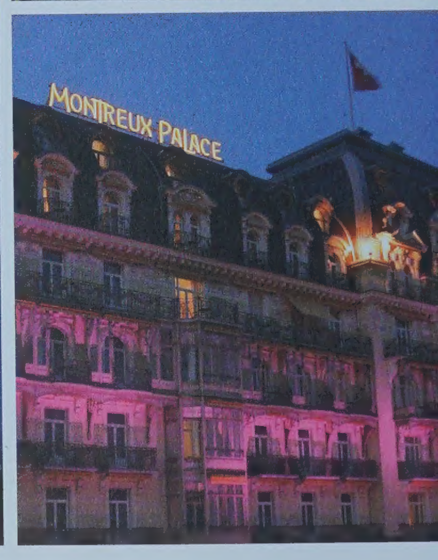
STOCK EXCHANGE
Toronto Stock Exchange
Symbol: TIR

ANNUAL MEETING
February 17, 2006 @ 10:00 am (PST)
TIR Systems Ltd.
7700 Riverfront Gate
Burnaby, BC
Canada V5J 5M4







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